International Labour Office

Social Aspects of European Economic Co-operation

Report by a Group of Experts

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Geneva, 1956

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PREFACE

The Group of Experts on Social Aspects of Problems of European Economic Co-operation, appointed in accordance with a decision of the Governing Body of the International Labour Office at its 128th Session (March 1955), was composed as follows :

Mr. Maurice BYÉ : Professor of International Economic Relations at Paris University, Faculty of Law ; Member of the French Economic Council.

Mr. T. U. MATTHEW : Formerly Lucas Professor in the Principles of Engineering Production, Birmingham University.

Mr. Helmut MEINHOLD : Professor of Economic and Social Science, Heidelberg University ; Member of Scientific Council, Federal Ministry of Economics ; Member of Market Research Committee of the High Authority, European Coal and Steel Community.

Mr. Bertil OHLIN : Professor at Stockholm Commercial College ; Member of Riksdag, Minister of Commerce 1944-45, Leader of the Liberal Party.

Mr. Pasquale SARACENO : Professor at the Università Cattolica del Sacro Cuore, Milan ; Central Director of I.R.I. (Istituto per la Ricostruzione Industriale) ; Secretary-General of Associazione per lo Sviluppo del Mezzogiorno (SVIMEZ).

Mr. Petrus J. VERDOORN : Professor of Market Analysis, Trade Statistics and Commercial Economics, Rotterdam School of Economics ; Deputy Director, Netherlands Central Planning Bureau ; Economic Adviser to Surinam Planning Board, 1951 and 1954.

Professor Ohlin was elected Chairman.

The group held two meetings, from 15 to 21 September 1955 and from 6 to 13 February 1956.

The report was the subject of a preliminary discussion in the Governing Body at its 132nd Session (June 1956) and is expected to be fully considered by it at its 133rd Session in November 1956.

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INTRODUCTION

1. Under our terms of reference as decided upon by the Governing Body of the International Labour Office at its 128th Session, we were to study and report on "the social aspects of problems of European economic co-operation".

2. The Governing Body took this decision after examining a report on the first European Regional Conference of the International Labour Organisation.[1] In interpreting our terms of reference we have been guided largely by the relevant parts of this document, especially paragraphs 17 and the following, in which four problems in particular were mentioned as calling for investigation : (1) the question whether international differences in labour costs and especially in social charges do or do not constitute an obstacle to the establishment of freer international markets ; (2) the need for policies designed to reduce to a minimum the hardships which closer economic co-operation may involve for persons engaged in particular industries ; (3) the question whether, if a freer international market were established, it might be necessary for the countries of Europe to shape and carry out their social policies with a greater degree of international consultation and co-operation than at present ; and (4) the social problems connected with freer international movement of labour.

3. In our view these are indeed among the most important social problems that have attracted attention whenever closer economic co-operation in Europe has been discussed since the war. Uncertainty and controversy over the nature and seriousness of these problems have hampered efforts to promote economic co-operation which might otherwise have gained much wider popular support. In the present report we attempt to clarify the main issues involved and to assess their relative importance. We also submit a number of practical suggestions for dealing with the more important social problems of closer economic co-operation.

4. The greater part of our analysis is devoted to the social aspects of the establishment of freer trade in Europe. This is because

[1] I.L.O.: *Minutes of the 128th Session of the Governing Body, Geneva, 1-4 March 1955*, pp. 73 ff.

three of the four main problems listed above are concerned with the attainment or the implications of freer trade while the fourth is closely related to it. We are, however, aware that many Europeans consider that freer trade, though it would make an important contribution to higher productivity and fuller utilisation of productive resources and thus to the raising of living standards which is the ultimate objective of closer economic co-operation in Europe, is but one of the approaches which should be adopted. Economic co-operation in Europe, they believe, should also include a vigorous common effort to raise rapidly and considerably the level of incomes in the poorer countries and thus to reduce the glaring disparities in living standards between different European countries and particularly between the southern areas and the north-western part of the Continent. They believe, further, that deliberate steps should be taken to ensure that the benefits of higher productivity resulting from closer economic co-operation will be reflected in improved living and working conditions. These views stem from the conviction that the ultimate objective of economic co-operation is to strengthen Europe's social framework and the stability of its social and political institutions. They are also in line with the basic philosophy of the Constitution of the International Labour Organisation and of the Declaration of Philadelphia, which assert that "universal and lasting peace can be established only if it is based upon social justice" and that "poverty anywhere constitutes a danger to prosperity everywhere".

5. The full achievement of these aims would call for arrangements for international co-operation going beyond the liberalisation of trade. Some of the problems of such broader co-operation fall clearly within our terms of reference and are discussed in Chapters II and VI of this report. Others, including the specific content of possible international action to improve particular labour and social conditions, go beyond our terms of reference and might be the subject of consideration by the appropriate organs of the International Labour Organisation.

6. Another point which arose in interpreting our terms of reference was whether "Europe" in this context should be taken to mean Western Europe or the whole of Europe. We noted that the various regional arrangements for closer economic co-operation which have been under consideration during the past few years have been limited to the countries of Western Europe and that it was as the outcome of a discussion in the first I.L.O. European Regional

Conference of some of the issues raised by such arrangements that we were asked to examine the social aspects of closer European economic co-operation. We have accordingly limited our analysis to the social aspects of such arrangements.

7. We have done so the more readily because we believe that there is no necessary conflict between the promotion of closer economic co-operation within a particular region and the pursuit of such co-operation on a broader basis. Through the General Agreement on Tariffs and Trade significant progress has been made in lifting restrictions on international trade and payments, and through the United Nations, the World Bank and the International Monetary Fund other significant contributions have been made to closer co-operation on a world-wide scale. These are most welcome achievements and it is clearly desirable that such efforts should be continued and intensified. At the same time, however, opportunities may exist for obtaining within smaller groups of countries more far-reaching results such as have been achieved within the framework of the Organisation for European Economic Co-operation, the European Coal and Steel Community and Benelux. It is therefore of special interest to examine the social aspects of such co-operation, as we have been asked to do, on a regional basis.

8. It is recognised that social welfare and the possibilities of raising social standards are closely related to, and to a large extent determined by, economic conditions. There is a widespread desire in Europe to benefit more fully from the advantages of closer international economic co-operation. The main steps which have been taken in this direction, together with certain proposals which are still under consideration, are summarised in Chapter I. Particular interest has been shown in the possibilities of establishing greater freedom of trade among European countries. The advantages of this and other forms of economic co-operation, and the special problems they would involve for the underdeveloped countries of southern Europe, are discussed in Chapter II. At the same time there is a widespread feeling that freer international trade should not be allowed to expose particular industries to artificial competition from abroad, and that competition from countries with lower labour standards and lower labour costs may be "unfair". This question is discussed in Chapter III. There is also some apprehension lest the costs and difficulties of the transition to a state of freer trade and a new pattern of international division of labour should prove to be excessive or should involve excessive hardship for particular

groups. Some measures which may be taken to reduce the costs of transition to a régime of freer trade, and to spread as equitably as possible over all sections of the community such costs as cannot be avoided, are discussed in Chapter IV. The question also arises whether the disturbances that may result from freer trade could be reduced and the advantages that would follow from the widening of the market could be increased by some harmonisation of social policies in different European countries. There is some uncertainty, in particular, as to how closer integration of European economies, if achieved, would affect the rate of social progress in Europe. Would it, for example, be more difficult for particular countries, especially those with more advanced labour standards, to raise wages or grant other social benefits if they were less sheltered than they now are from foreign competition? Conversely, in what ways might closer economic co-operation serve to stimulate social progress, especially in countries with less advanced labour standards? These questions are discussed in Chapters IV and V. The contribution which freer movement of labour and capital might make to closer economic co-operation is touched on in Chapters I, II and IV ; and in Chapter VI we consider in more detail the obstacles to the movement of these factors and the problems involved in any substantial reduction of these obstacles.

9. In Chapter VII we give a summary of our conclusions, together with references to the various parts of the report in which a fuller statement of these conclusions may be found. While the members of the Group have been in agreement on most of the conclusions concerning matters of practical policy, Professor Byé disagrees with parts of the analysis on which certain of these conclusions are based; his views on these points are stated in a note of dissent. Some comments on the relation between Professor Byé's views and those expressed in the main body of the report are made in a brief supplementary note by the Chairman.

10. The report is accompanied by three appendices. The first, prepared by the International Labour Office, attempts some international comparisons of wages and social charges in Europe ; the second, by Professor Ohlin, discusses some of the effects of tax policies on international trade ; the third, by Professor Verdoorn, contains an estimate of the changes in trade to be expected under a customs union.

PART I

CHAPTER I

APPROACHES TO CLOSER ECONOMIC CO-OPERATION

11. The widespread desire for closer economic co-operation in Western Europe has given rise to a striking number and variety of plans and proposals with this end in view. Some of these have not got beyond the stage of study and discussion ; on others, practical action has been taken. A brief catalogue and some classification of the principal approaches to closer economic co-operation in Western Europe which have recently been undertaken or considered by governments will, we believe, help to set the main body of this report in perspective.[1]

12. The Organisation for European Economic Co-operation, established in April 1948 to serve in the first place as the European agency for the administration of the Marshall Plan, has (as was foreshadowed in the Convention under which it was established) assumed long-term responsibilities extending beyond its primary function. Its two main achievements relating directly to freer trade among European countries have been the creation of the European Payments Union and the simultaneous establishment of the Code of Trade Liberalisation. The European Conference of Ministers of Transport, set up in October 1953, is administratively attached to the O.E.E.C., though functionally independent.[2] In addition, it has

[1] For a more detailed account of most of the organisations described in this chapter see Council of Europe : *The Present State of Economic Integration in Western Europe* (Strasbourg, 1955), especially Chapter III. First-hand documentation is too voluminous to be cited here. Useful secondary sources include M. T. FLORINSKY : *Integrated Europe?* (New York, MacMillan, 1955) (this book contains a valuable bibliographical note) ; F. PERROUX : *L'Europe sans rivages* (Paris, Presse universitaire de France, 1954) ; and A. PHILIP : *L'Europe unie et sa place dans l'économie internationale* (Paris, Presse universitaire de France, 1953).

In addition to the various official plans, there have been a number of proposals by private individuals or groups which have helped to stimulate a widespread popular interest in the subject.

[2] European intergovernmental co-operation in the field of transport has also been facilitated by the Inland Transport Committee of the United

(footnote continued overleaf)

recently been decided to create, within the organisational structure of the O.E.E.C., a Ministerial Committee for Agriculture and Food which is to continue the work originally started by the "Green Pool". [1]

13. The European Coal and Steel Community constitutes the first attempt to utilise a supra-national institution as a vehicle for the establishment and operation of a single market extending across national frontiers. A "common market" for coal was established in February 1953 and for steel in May 1953. We refer to this Community at various points throughout the present report.

14. The Benelux economic union, comprising Belgium, Luxembourg and the Netherlands, achieved the abolition of customs duties within the union and the establishment of a common tariff against outside countries in 1948. In 1949 all quantitative restrictions on intra-Benelux trade in industrial goods were abolished, but a special system was introduced for many agricultural goods. A recent development is the agreement, concluded in May 1955, to undertake the gradual harmonisation of agricultural policies over a seven-year period with a view to the ultimate freeing of intra-Benelux trade in agricultural products. There has existed throughout the post-war period a common employment market in so far as manpower movements are free within the union area. An agreement of July 1954 provided for extensive liberalisation of capital transfers within the area. This has led to important capital movements from the Netherlands into Belgium.

15. Negotiations for the formation of a Franco-Italian customs union, which was to lead to an economic union, were initiated in 1947 and a draft treaty was initialled in 1949, but the final version of the treaty (June 1950) contains little more than an expression of the intention to "harmonise" the customs legislation of the two countries. Other customs union proposals, for "Fritalux" (a union of France, Italy, the Federal Republic of Germany and Benelux) and for a Scandinavian union, have not so far gone beyond the exploratory stage.

Nations Economic Commission for Europe. This Commission has in addition promoted European economic co-operation in a variety of other ways. It is the principal, if not the only, intergovernmental agency through which economic co-operation between Eastern and Western Europe can be promoted and has been active in promoting increased trade between the eastern and western regions.

[1] See Chapter IV, para. 193 below.

16. In July 1954 a convention establishing a common employment market in the northern countries entered into force as a result of its ratification by Denmark, Finland, Norway and Sweden. In August 1954 the Nordic Council, composed of parliamentarians from the countries concerned and created in 1952 as a forum for the discussion of matters of common northern interest, adopted a resolution urging the governments to establish the necessary conditions for a common market in certain industrial sectors.

17. At the Torquay conference of the General Agreement on Tariffs and Trade (1951) a proposal was put forward by the French Minister of Trade, Mr. Pflimlin, aiming at a series of gradual tariff reductions within the general framework of the General Agreement.

18. The Council of Europe, with its Consultative Assembly elected by the parliaments of member countries and its Committee of Ministers, has done much to focus and maintain interest in projects for closer European economic co-operation, and the Consultative Assembly has itself put forward several plans which have not, as yet, led to practical action. One of these, presented in 1951, was for a "low-tariff club" which would comprise the 15 States Members of the Council of Europe and would have as its first objective the limitation of tariff scales to fixed percentages. Goods would be divided into four categories : raw materials, semi-finished goods, finished goods and foodstuffs, and a ceiling would be established for each. Furthermore the contracting parties would undertake to meet at the end of a prescribed number of years to re-examine these percentages and progressively reduce them. Another proposal, known as the Strasbourg Plan and put forward in 1953, was designed to increase production both in countries which are members of the Council of Europe and in overseas countries having constitutional links with them, to expand trade between these countries and to contribute to the solution of dollar payments difficulties. These objectives were to be sought through the establishment of a European Bank for the development of overseas territories, working in close co-operation with the International Bank for Reconstruction and Development ; through the conclusion of long-term contracts and international agreements on basic products, covering both quantities and prices, thus giving producers greater security and encouraging an expansion of output ; and through the introduction of reciprocal commercial preferences between the Commonwealth and dependent territories on the one hand and the other countries in the area on the other.

19. At a Conference of Foreign Ministers of the six States Members of the European Coal and Steel Community, held at Messina in June 1955, the six governments expressed the view that the time had come for a new step in the direction of closer European unity, particularly in the economic sphere, and they agreed on the following objectives :

(a) joint study of plans for development based on better co-ordination of land and air transport ;

(b) exchanges of gas and electricity and study of methods of co-ordinated development of the production and consumption of energy ;

(c) study of the establishment of a joint organisation to which would be attributed the responsibility and the means for ensuring the peaceful development of atomic energy ;

(d) the achievement by stages of a European market free of all customs duties and of quantitative trade restrictions ;

(e) the establishment of a European investment fund with a view to the joint development of European economic potentialities, and, in particular, the development of the less advanced regions of the participating countries ; and

(f) study of the progressive harmonisation of the provisions in force in the different countries concerning, especially, hours of work and premium payments for work at night, on Sundays and on holidays.

20. It was further decided that conferences should be convened to negotiate treaties or arrangements relating to these various matters, and that work in preparation for such conferences would be carried out by a committee of government delegates assisted by experts.

21. The various achievements, plans and proposals catalogued above do not lend themselves to simple classification. Some distinctions may, however, usefully be drawn. In the first place a distinction may be drawn between measures involving a "global" approach to the problem of establishing closer co-operation and measures involving a "sector" approach. A global approach includes measures embracing all or most economic sectors, as under the Benelux economic union ; a sector approach includes only measures relating to particular sectors, as under the European Coal and Steel Community. In the following chapters we discuss mainly the problems involved if a global approach is adopted, but problems of a sector approach are referred to at various points.

22. Cutting across the above distinction, a further distinction may be drawn between *(a)* measures to promote greater freedom of trade in commodities [1] or services or greater freedom for labour or capital to move at will from one country to another; and *(b)* measures designed actively to stimulate or to co-ordinate international trade, the movement of productive factors, or research and the exchange of technical knowledge. Measures of these various kinds may be found in combination, as in the Benelux economic union, or separately (for example, the common employment market in the Scandinavian countries).

23. Finally, as will become apparent from our analysis in the next chapter, an important distinction is that between schemes for closer economic co-operation among countries which have reached an equally advanced stage of industrialisation and economic development (such as the Benelux countries) and among countries between which there are wide differences in levels of economic

[1] Liberalisation of commodity trade on a regional basis may in turn be achieved through a variety of alternative approaches, including:

1. Measures to reduce import and export duties:

(a) Establishment of a customs union (or preliminary agreements looking towards the establishment of a customs union). By a customs union we mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce are eliminated with respect to substantially all the trade between the constituent territories of the union, or at least with respect to substantially all the trade in products originating in such territories; and

(ii) substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union.

(b) Establishment of a free-trade area (or preliminary agreements looking towards the establishment of a free-trade area). A free-trade area resembles a customs union in that duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories, but differs from a customs union in that the constituent territories do not apply the same duties and other regulations of commerce to their trade with territories not included within the free trade area.

(c) Establishment of tariff concessions between a group of countries —a "low-tariff club" in which, however, tariffs on trade between co-operating countries are not completely eliminated.

[Definitions *(a)* and *(b)* above are based on those contained in the *Havana Charter for an International Trade Organisation, March 1948*, Article 44, paras. 4 and 5, and in the *General Agreement on Tariffs and Trade*, Article XXIV, para. 8 (General Agreement on Tariffs and Trade: *Basic Instruments and Selected Documents*, Vol. I, Geneva, 1952, p. 54).]

2. Measures to eliminate quantitative restrictions on trade.

3. Measures to control non-governmental restrictive practices in trade.

development and income (such as the group of countries co-operating in O.E.E.C.).

24. For reasons which we have indicated in the Introduction, we devote our attention mainly, though not entirely, to the social implications of a liberalisation of commodity trade. In Chapter IV, for purposes of discussing shifts in the pattern of trade, production and employment, we assume that it is decided to set up a customs union, and this same assumption is made by Professor Verdoorn in Appendix III. But elsewhere we speak simply of "freer trade" without prejudice to the question of what particular approach to freer trade—for example, the establishment of a customs union, a free-trade area or a low-tariff club—may be adopted.

CHAPTER II

THE ADVANTAGES OF CLOSER ECONOMIC CO-OPERATION

Freer Trade, Wider Markets and Economic Growth

25. The most important contribution of freer trade to the raising of living standards is through its effects on economic growth. There is economic growth when material resources and incomes increase faster than population. The process of economic growth involves, however, more than increasing productivity. When incomes per head are rising, the level of demand will normally increase ; the composition of demand will also change, because at higher incomes new types of products are wanted. Both factors open up opportunities for new investment, the resources for which are also available when aggregate income is increasing. If, as is normally the case, a high level of gross investment accompanies economic growth, productivity will rise further : not only does the amount of equipment per worker increase but a strong demand for investment goods will lead to improvements in the nature of, and methods of producing, investment goods and will stimulate new inventions. In addition, a growing economy or sector of the economy may in certain conditions attract capital from other countries or sectors. Thus, once it has started, the process of economic growth tends to become a self-sustaining cumulative process. However, as we shall see below, there may be conditions in which economic growth cannot easily be initiated : when, for one reason or another, incomes do not rise, it is difficult to set the process of economic growth in motion.

26. Freer trade may be expected to contribute to the raising of incomes and living standards through the effects of widening markets on productivity and on the acceleration of economic growth. This increase in productivity will come about in a number of ways, including economies of scale and of specialisation, improvements in commercial organisation and more rapid diffusion and application of technical advances.

27. The small size of many national markets in Europe presents obstacles to the growth of firms to a size at which they can take full advantage of the economies of large-scale enterprise. These economies include the facts that the cost of large transactions and operations is often little, if at all, greater than that of smaller ones ; that reserves of stocks needed to meet certain contingencies can be relatively smaller as the volume of business increases ; and that larger firms can more easily achieve balance in the capacities of the groups of machines needed for consecutive operations. In addition, large firms can usually obtain better credit terms than smaller ones.

28. The economies of specialisation appear to be even more important than those of large-scale enterprise (with which in practice they may often go together). Freer international trade, on the basis of differences in comparative costs within widening markets, is one of the most effective methods of promoting specialisation. The advantages of specialisation derive from large-scale production of one or a few standard lines, and can often be secured even if the size of the firm (as measured, for example, by the number of workers or the value of sales) is not large. They include the possibility of utilising special-purpose machinery and equipment, greater scope for workers and managerial personnel to specialise in particular tasks in which they can acquire increased skill and dexterity, the production of larger runs of particular items, reduced tooling and set-up times, simpler and cheaper inspection procedures and so on.

29. In addition to such advantages of mass production, which operate mainly within the individual firm, there are important external factors leading to higher productivity and reduced costs. These include improvements in the production and delivery of raw materials and semi-finished products, improved training and educational institutions, the development of a skilled local labour force, the stimulation of new inventions and, when the total volume of production in a particular area justifies it, the development or improvement of basic facilities such as banking, communications and power. The development of wider and more stable markets as a result of trade liberalisation is likely also to result in a considerable improvement in the organisation of purchases and sales. When there are no trade barriers and particularly when there is no substantial risk that neighbouring countries will erect new obstacles to trade or payments, it pays to develop a more effective sales

organisation, thus reducing costs and further widening markets, and to establish new contacts, for example, for subcontracting abroad, thus further promoting specialisation within and among countries.

30. Freer international trade may also be expected to lead to higher productivity through a more intensive international exchange of technical knowledge and experience. First, the more rigorous competition will spur producers to look for and apply improved methods of work. Secondly, to the extent that freer international movement of goods and capital leads to the establishment of branch factories abroad, technical knowledge will be made available to the countries in which the branches are set up. Thirdly, one may expect closer economic co-operation between European countries to be accompanied by closer international co-operation in such fields as the setting up of international educational institutions and of other arrangements through which knowledge and experience could be exchanged.

31. These advantages of the widening of markets are the basic case for the liberalisation of trade. Not only will such liberalisation lead to the replacement of less by more efficient producers but the fact that the market is widened will enable the low-cost producers to effect further substantial cost reductions. The internal and external economies of specialisation constitute the main reason why countries which have reached a higher level of industrial development have become each other's best suppliers of, and customers for, industrial products, even when the differences in their endowments of productive factors (amount of capital available per worker, high standards of vocational training, climate and so on) are not very great. While differences in factor endowments are a basic cause of international division of labour, specialisation within broad groups of productive activity such as manufacturing, agriculture and services has created new patterns of differences in comparative costs and vast opportunities for an increase in mutually advantageous trade.

32. One important aspect of this situation is that the nature of international specialisation is to some extent determined by historical accident. Because the internal and particularly the external economies of specialisation take time to reach their full development, those firms and countries which first started the production of particular items tend to become more and more

efficient and it becomes increasingly difficult for other firms or other countries to get a footing in the same field. This is not particularly serious when international specialisation takes place within the broad groups of manufacturing, agriculture and international services. In that case, each country can have a substantial volume of industrial production for itself and enjoy the higher productivity and living standards which secondary and tertiary production permit. However, the situation is different when a country is entirely or largely dependent on agriculture and has little or no manufacturing industry of its own. In such circumstances the country in question may find it extremely difficult to develop any manufacturing industry in competition with the older-established industries in more highly developed countries. Considerations of this nature have formed the basis for the "infant industry" argument for protection—the argument that an industry which a country may in the long run be able to carry on no less efficiently than its competitors may never get a footing in that country unless it is protected in its early stages against competing industries abroad with their acquired skill and experience, contacts with markets and sources of supply and similar advantages. This argument, which in a wider application might be called "the industrially undeveloped region argument", is still relevant in the conditions which prevail in southern Europe, though it does not follow that tariff protection is the only, or even the best, solution to the special problems of this region. We discuss these problems in greater detail below.

Effects of Unequal Economic Growth: an Example

33. It is instructive in this connection to recall the experience with economic integration following the unification of the Italian states between 1859 and 1870. Prior to this unification the southern regions of the country were already largely dependent on agriculture, which even then was rather backward compared with agriculture in most other Italian states and in other European countries. There was some industry, protected by tariffs about four times as high as those applied in the other Italian states. Communications were also even less developed in the south than in the other Italian states.

34. At the time it was taken for granted that the large new national market which resulted from political unification would

spontaneously bring about more rapid economic development in all the former states. It was thought, for example, that capital would be invested all over the country and that the relative poverty of the south, far from being an obstacle to its industrialisation, would constitute an advantage because the relatively low wage level would attract capital for industrial investment. This conception left little scope for government development policies on behalf of the south.

35. In actual practice the elimination of tariffs between the southern and northern areas led to the virtual disappearance of the southern industries, while those of the north (which initially were only weakly protected) enjoyed most of the advantages of the new national market. Between 1883 and 1888 the northern industries were given a new impetus by the introduction of highly protectionist policies, but since no special measures were taken to foster industrial development in the south that area remained stagnant and, indeed, suffered as a result of the deterioration of the terms of trade between agricultural and industrial products following the introduction of duties on industrial goods. During the two world wars new industries were established and existing ones expanded, again in the north ; during the post-war inflations large amounts of capital flowed from the south to the north with its better opportunities for investment ; and between the wars measures taken to remedy a financial crisis had the effect of permitting northern industries to write off their capital investments within a very short period, thus again strengthening the competitive position of these industries.

The Underdeveloped Areas of Southern Europe

36. In all the countries considered in this report there are areas which are economically underdeveloped. Such areas are, however, particularly extensive in the countries of southern Europe.[1] Incomes per head are much lower than in northern and western Europe, industry is far less developed and a large part of the population is dependent on agriculture, and the productivity of land and labour is low. The rural population is not fully employed : there is a large labour surplus, in the sense that a substantial number of workers could be withdrawn from agriculture without causing a significant fall in agricultural output.

[1] No attempt is made in this report to consider the special problems of the non-European territories of European countries.

37. In such circumstances the most effective means of raising average incomes would be to find productive employment opportunities for the labour surplus, either in the countries themselves or abroad. Land being scarce in relation to the size of the rural population, the obvious method of creating employment within these countries would be to develop industrial production. The areas in question have, however, found it extremely difficult to develop new industries. The problems involved are relevant to questions of closer economic co-operation and we therefore devote the next few pages to a discussion of the special difficulties which the liberalisation of trade presents for these areas.

38. The development of southern Europe is indeed a common interest of all European countries : higher living standards in this region are desirable both for their own sake and for the wider market they can provide for the products of all countries. The removal of trade restrictions does not always guarantee, however, that enough capital will become available to promote a sufficiently rapid rate of economic growth in all the countries concerned. Trade liberalisation may need, therefore, to be accompanied by special measures to encourage capital formation in southern Europe.

39. There seem to be two main inter-related obstacles to the industrialisation of the underdeveloped areas of southern Europe. First, these areas have not as yet developed to an adequate degree institutional arrangements—educational facilities, public administration, credit institutions and tax policies—of a kind which would encourage the accumulation and investment of capital, and for this and other reasons they lack the large amounts of capital needed both for the basic facilities (such as roads and other communications and power grids) which are a prerequisite to any considerable industrial development, and for the actual establishment of factories.[1]

40. There seems to be a clear tendency for new industrial investment to cluster in areas where some industry already exists. Such areas offer at least two important advantages over other areas : first, a labour force accustomed to industrial working methods is available and general industrial facilities such as banking, training and consulting services and communications are better developed. Secondly, incomes are higher and local markets are larger so that a

[1] Similar conditions prevail in the underdeveloped and depressed areas in other countries but since they are of relatively smaller importance they can, in these countries, often be overcome by a gradual reallocation of the existing stock of capital.

certain degree of specialisation in the production of materials and parts becomes possible. As a result the whole economic environment is much more attractive to investors than in areas where no industry yet exists.

41. There is thus no reason to expect that capital will flow automatically from industrialised to underdeveloped areas. Unless positive action is taken to encourage such a flow the scarcity of capital in these areas may continue indefinitely and the disparity in economic levels between those and other areas may be further accentuated.

42. As was mentioned above, disparities in economic growth have given rise to the "infant industry" argument for protection. The case for protection in underdeveloped areas, however, goes beyond the original infant industry argument. There is a second major obstacle to the development of those areas, namely the fact that, in the special conditions which there prevail, the structure of money labour costs does not accurately reflect real costs in the sense of the value of alternatives foregone. A few words of explanation may serve to make this point clear.

43. In a fully employed economy the labour required to achieve a lasting increase in the production of any commodity can only be obtained (except to the extent that the supply of labour is increasing) by withdrawing it from the production of other commodities. The fact that more output in, for example, the engineering industry can only be obtained by withholding some labour from other industries, such as textiles, means that the real cost of more engineering products is less textile products. Abundance and scarcity of various goods (in relation to needs and effective demand) are reflected in relative prices.

44. The situation is different where there is a large and persistent surplus of labour—where, for example, a number of workers could be withdrawn from agriculture without reducing agricultural output. In these circumstances the real cost of employing additional labour in industry may be close to zero. Whatever a worker can produce when employed in industry thus constitutes a net gain to the community (except that some cost may be involved in his transfer to and settlement in an industrial environment).

45. The money cost of employing such workers in industry, however, could not possibly fall to a level close to zero. Workers

will not accept employment in industry unless the wages offered are at least equal in real terms to the incomes which they earn as independent farmers or as members of a farming family. As a result of the action of trade unions and certain other factors, wages in industry may, indeed, be substantially higher.

46. In this connection it is to be noted that agriculture in the underdeveloped countries is largely family farming involving little or no use of hired labour. The normal commercial principle that a wage earner is hired only if his employment yields an addition to the value of output at least equal to the amount of his wage does not apply in family farming. When there are no alternative employment opportunities members of the family will stay on the farm and share in the family's income even when the same output could be produced without their services. So long as the wage to which such workers would be entitled in manufacturing is too high to make their employment remunerative to the private employer, they may continue to be "employed" in agriculture even though the money value of their services in manufacturing would be so much greater than the money value of the decrease, if any, in agricultural output which would result from their transfer to manufacturing that a shift of labour away from agriculture towards manufacturing would be advantageous to the community as a whole. This will be the case whenever the market value of an additional worker's output in manufacturing is less than the current rate of wages as determined by the level of subsistence income in agriculture, the policies of the trade unions and other relevant factors.

47. The result seems to be that where widespread structural unemployment or underemployment prevails capital investment tends to concentrate in certain areas where industrial facilities are available and where methods of production are used which require a level of capital investment per worker higher than would correspond to the over-all relative scarcity of labour and capital in these countries. Consequently, goods are produced, and even exported, which are so capital-intensive that they could with advantage have been imported. On the other hand, because capital is used abundantly in these types of production there is not enough to equip the whole labour force.[1]

[1] Such an "over-capitalisation" in particular sectors may for technical reasons be unavoidable and it may not be altogether disadvantageous. For example, if the country in question can count on a substantial increase in its capital stock in the reasonably near future (through capital imports

48. Having regard to the nature of the obstacles to industrial development in large areas of southern Europe there is, in our view, a risk that under the ordinary mechanism of free trade the present unproductive economic structure of these areas might tend to be perpetuated—a risk, that is to say, that investment would continue to be concentrated in the areas which already are highly industrialised and that the gap between incomes and living standards in these and the underdeveloped regions would become still wider.

49. There is, therefore, in our judgment, a case for exempting the countries of this region from some of the obligations which other partners would assume under schemes for trade liberalisation, provided these countries undertake effective programmes to promote industrialisation of their underdeveloped regions by providing basic facilities in such fields as power, communications and urban land development and by creating or maintaining appropriate arrangements for the education and training of workers, the efficient organisation of the employment market, adequate public administration, banking and credit institutions and a system of taxation, at both national and local levels, that will encourage domestic saving and investment and will not constitute an unnecessary deterrent to foreign investment. With respect to the organisation of the employment market we would like to call special attention to the importance of suitable incentives for the transfer of manpower to the places where it can be used most productively. Incentives of this kind are provided, for example, through the Fund for Reconversion and Readaptation of the European Coal and Steel Community to which we refer in Chapter IV.

50. In order to make the employment of surplus labour more remunerative, by bringing the money cost of such employment closer to the real cost involved, consideration might be given to the maintenance by underdeveloped countries, during a transition period, of import duties on commodities which they could produce by methods requiring the use of relatively large amounts of labour. It has indeed been suggested, in a study prepared for the Economic Commission for Europe, that a flat rate of duty *ad valorem* might

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or domestic savings), it may be justified in establishing certain capital-intensive industries even before the larger capital resources have actually become available. Another consideration which may sometimes carry weight is the fact that if somewhat more advanced methods of production are used, and if some engineering industries are established, the labour force can develop certain technical skills which may facilitate more rapid growth of industries and employment in the country concerned.

be applied uniformly, in the southern European countries, to all industrial products which could reasonably be produced there. "The level of the duty", it was suggested, "would have to vary from country to country in inverse proportion to the degree of development."[1] If such protection were initiated the need for it would, however, diminish as industrial development proceeded and the rates of duty should accordingly be progressively reduced.

51. Many of the same effects of protection might, however, be achieved by subsidising the products of infant industries. This method offers certain advantages as compared with the application of import duties. For one thing, subsidies lower the price of the product instead of raising it and thereby help to broaden the market. Secondly, since subsidies constitute, from the government point of view, an outlay instead of a receipt, they are apt to be considered more critically in the country itself and the danger that protection would be excessive, either in level or in duration, would be less than in the case of import duties. Another reason for preferring subsidies to protection is that in many cases only part of a country is underdeveloped and protection granted to industry in general might foster the further expansion of industry in the developed areas rather than the establishment of industries in the underdeveloped areas. Against these advantages there is the drawback that subsidisation may, in certain cases, involve serious risks of administrative corruption.

52. Another possible alternative to protection, when the necessary capital is available, may be the provision through public investment of such basic facilities and services—roads and other communications, power, educational and training facilities, and so on—as will make the underdeveloped areas more attractive to the private investor.

53. Even in poor countries some income is saved and, as incomes begin to rise as a result of a development programme, it may be possible to increase the volume of savings for investment. Unless suitable banking and credit institutions are developed to channel such savings into productive investment, there is a danger that savings may remain unused or be sent abroad or be used for types of investment that will not make the greatest possible contribution to economic development. It is therefore of the utmost

[1] United Nations, Economic Commission for Europe: *Economic Survey of Europe since the War* (Geneva, 1953), p. 220.

importance that appropriate institutions be developed for this purpose. Special incentives may have to be devised to ensure that an economic use is made of the available supply of capital. Such a programme for balanced development is one of the aims of what is known as the Vanoni Plan in Italy.[1] While the problems of the underdeveloped countries are different in certain respects from those of depressed areas in countries that are already economically developed, we have noted with interest some of the measures that have been taken to encourage balanced development in these depressed areas. Examples of such measures are the Development Areas Programme in the United Kingdom, the Tennessee Valley Authority in the United States, the special inducements offered to investment in the Flemish areas of Belgium and the programmes to encourage investment in northern Norway.

54. Successful programmes for balanced development in the underdeveloped countries are, however, likely to require more capital than these countries can be expected to raise from their own resources. Countries suffering from substantial structural unemployment might therefore reasonably make their adherence to schemes for trade liberalisation dependent on a measure of international co-operation in solving the problem of under-utilised manpower resources in Europe. Such co-operation might take the form of loans and investments, the admission of migrants from the poorer into the richer countries, internationally financed training programmes or any combination of such measures.

Economic Growth and International Movements of Labour and Capital

55. In view of the foregoing, we have given consideration to some questions which would be raised if international economic co-operation in Europe were to include freer international movement of manpower and capital as well as freer trade in commodities.

56. The general economic effect of international movements of capital and labour is that they alter the proportions in which these factors are distributed among various countries. Other things remaining equal, some countries will dispose of more manpower or

[1] See "The Vanoni Plan for the Economic Development of Italy", in *International Labour Review* (Geneva, I.L.O.), Vol. LXXI, No. 6, June 1955, pp. 616-634.

more capital than would otherwise have been available to them and in other countries one or the other of these resources will become relatively less abundant. If capital moves away from countries in which it is relatively abundant towards countries in which it is relatively scarce and if labour does likewise, the proportions in which they are combined in the various countries will become less different. This does not mean that international trade in commodities would come to an end, or even that its volume would necessarily be reduced. Although there would be less international division of labour based on differences in the labour or capital intensity of production, there would, as a result of increasing production, be increasing scope for specialisation, on the basis of differences in comparative cost, within particular types of industry such as manufacturing. For example, one would not expect a situation to arise in which all engineering industries were located in one country while other countries had no such industries, but rather that there would be certain countries specialising in, for example, machine tools or certain types of machine tools and others specialising in transport equipment. Secondly, if and as international movements of labour and capital lead to a particularly rapid rise in living standards in what are now the poorer areas of Europe, these areas would demand more imports and thereby help to increase the volume of international trade.

57. International movements of labour or capital will also affect wages, capital earnings and incomes generally in the countries concerned. Other things remaining equal, the factor in question will become less scarce in the receiving countries and its rate of renumeration there will tend to become lower than it would otherwise have been. In the countries from which labour or capital moves away the factor will, other things again remaining equal, become less abundant and the rate of income it earns will tend to become higher than it would otherwise have been. As a result, if capital and labour move from countries in which they are relatively abundant to countries in which they are relatively scarce, international differences in wages and capital earnings will tend to become smaller.[1]

[1] As is observed in Chapter V, freedom of international trade by itself also tends to reduce international differences in relative and absolute levels of income for labour and capital. Real incomes will tend to rise in all participating countries, but the incomes of particular factors (labour, capital, etc.) will tend to rise faster in countries where they are low than in countries where they are high. Free international movement of factors would have the effect of accelerating this tendency.

Of course, not all the benefits of higher productivity can be added to the national income of capital-importing countries. That part of the additional income which has to be paid to the foreign investor by way of interest or dividends has to be deducted. In normal circumstances, however, a country will on balance benefit from the increased supply of capital which will enable it to make better use of its land and labour. In particular it is likely that labour will gain from the import of capital.

58. From what we have said in the beginning of this chapter it will, however, be clear that other things will by no means remain equal. For example, imports of capital into countries where levels of income and savings are low provide an opportunity for generating a cumulative process of economic growth. Not only would the amount of capital per worker increase but at least in the case of private capital imports fresh industrial initiative and technical knowledge would normally accompany the international movement of capital. It may be noted that international movement of labour may also increase the international exchange of technical skill and experience : when skilled technicians migrate the receiving country can improve its technical standards. Conversely, workers temporarily employed in a foreign country will acquire new skills, learn new methods and become acquainted with new types of equipment.

59. In some respects the situation is the reverse in the capital-exporting countries. In the short run, capital in these countries may become less abundant, the growth of investment per worker may be slower and the increase in productivity smaller than they would have been if the capital had remained within the country. From this point of view it might indeed be said that in the richer countries also capital is scarce : the generally accepted objectives of full employment and rapidly increasing productivity require heavy investments which are likely to continue to use up whatever savings can be made even at the higher income levels of the richer countries. It is clear, therefore, that if these countries are to make large sums of capital available to the poorer parts of Europe by permitting private capital exports or by making intergovernmental loans, this may involve a somewhat slower increase in their own productivity, at least during a certain time.

60. On the other hand, the acceleration of economic growth in the capital-importing countries will counteract some of these adverse effects at least to some extent. First it may be argued,

though this reasoning applies to somewhat special cases only, that if capital exports also lead to an increase in the export of capital goods, some of the capital-exporting country's industries (particularly engineering and electrical industries) may expand to an extent which make possible additional economies of scale. Secondly, because capital exports tend to accelerate growth and to raise living standards abroad, they also pave the way for a lasting expansion of foreign markets. Particularly if obstacles to trade in commodities are reduced simultaneously, the increasing volume of trade and the increasing specialisation in production will tend to stimulate economic growth and to raise productivity in the capital-exporting countries. Thirdly, capital-exporting countries may in the long run benefit from new cheap sources of supply for imports that are developed with the aid of the capital exports. Large-scale investment in certain European areas may make it possible to increase rapidly the production of commodities for the import of which Europe is now largely dependent on the dollar area ; in the first few years of the European Recovery Programme considerations of this nature played an important role in plans for increasing and co-ordinating investment at the international level. Finally, as is observed in Chapter IV, freer international movements of capital may mitigate problems of transition to freer international markets for commodities. In view of these considerations[1] it seems uncertain whether capital-exporting countries or the workers in these countries would in practice suffer from the export of capital. Even though in some cases they might lose during an initial period, it seems likely that in the long run the combined effects on rates of growth in the participating countries of a moderate export of capital and a freer market for commodities will ensure that there is a rise in real wages and in real incomes generally in capital-exporting countries, even though the rise in capital-importing countries may be even larger.

61. In the underdeveloped countries themselves restrictions on the export of capital may need to be maintained. As was pointed out above, the productivity of both capital and labour is likely to remain very low until basic industrial facilities (communications, power, etc.) have been developed. The net savings of low-income

[1] There may also be non-economic, for example, political, reasons for making more capital available to the underdeveloped areas of Europe, even if this would involve some sacrifice on the part of the capital-exporting countries. Our terms of reference do not, however, require us to go into these questions.

countries, even over a period of several years, are not likely to suffice for full development of these facilities, and while this development is taking place the returns on private savings invested abroad may well be higher than those which could be earned at home ; capital owners will therefore tend to invest abroad. If, however, restrictions on the export of capital are to serve the purpose of raising domestic investment in the underdeveloped countries to the full amount of domestic savings, restrictions on capital exports will need to be accompanied by measures designed to mobilise these savings for domestic investment ; otherwise they might be used for consumption or dissipated in projects that contribute little to the economic development of the countries concerned.

62. For the same reasons which tend to lead to an undesirable export of capital from the underdeveloped countries it is unlikely that private capital movements into these countries could in the foreseeable future be relied upon to provide the capital they need. Such capital as might be made available by the high-income countries for the purpose of developing basic facilities in the underdeveloped countries would probably have to be transferred under government-sponsored international capital transactions.

63. Another more general reason for retaining a certain degree of control of international capital movements might be the wish to prevent sudden flights of capital away from certain countries. It seems clear that erratic, short-term movements of capital, for example caused by political events, can adversely affect monetary stability and productivity in both the capital-importing and the capital-exporting countries. At the same time there would, of course, have to be some room for short-term capital movements to facilitate adjustment of temporary disequilibria in international payments.

Public Capital Movements and a European Investment Bank

64. We have much sympathy with a proposal put forward in a report published by the Secretariat-General of the Council of Europe [1] to the effect that a European Investment Bank should be established. If it were left to each country to determine the direction and volume of its own exports of capital, there would be no assur-

[1] Council of Europe : *Full Employment Objectives in Relation to the Problem of European Co-operation* (Strasbourg, 1951), pp. 65 ff.

ance that capital would be channelled to the countries where it would be used most advantageously from a European point of view, nor that the timing of loans would be such as to enable borrowing countries to plan ahead with any degree of confidence. The Bank might analyse and compare development schemes submitted to it, finance them and exercise some supervision over their execution. It is suggested that it should grant loans mainly to central governments rather than to particular private enterprises and that loans should be granted for general development purposes and need not be tied to specific projects. It is further suggested that development programmes should be laid down for a period of years and that the Bank's contributions should similarly be determined on a long-term basis so as to facilitate long-term planning. The Bank would derive its capital from direct contributions from member governments in their respective national currencies, subscribed over a period of years, but should have power to increase its lending capacity beyond its basic capital through additional loans from individual governments or through the issue of bonds on the capital markets of member States.

65. While we have not examined the details of this scheme, the general idea of a European investment bank appears to us a sound one. The specific proposals made by the Council of Europe Secretariat therefore merit careful study by the governments concerned.

Monopolistic Practices, Government Policies and International Trade

66. Orthodox classical interpretations of the mechanism of international trade, while on the whole still relevant to international economic relations, rest on a number of rather special assumptions. [1] These include the existence everywhere of perfect competition [2], virtual absence of government intervention in economic affairs, absence of international movements of labour and capital but perfect mobility of these factors within each country and absence of

[1] These assumptions have been modified in several respects in the so-called neo-classical theories of international trade.

[2] In the special sense attached to that term in economics, denoting a state of affairs in which, among other things, entrepreneurs, wage earners and capital owners seek to maximise income at prevailing prices, wages and interest rates without being able to influence these individually and without attempting to influence them by collective action.

increasing returns. With the aid of these and certain complementary assumptions it can be demonstrated that free trade, on the basis of differences in comparative costs, is in the interest of each participating country because it enables each country to specialise in the production of the things which it can produce relatively most cheaply and to import in return those things which it would be more costly to produce at home.[1] In this way a larger total flow of goods and services can be produced and shared among the peoples of all countries. Market forces of supply and demand will translate differences in comparative cost in terms of money prices and costs and thus will automatically lead to the best possible international division of labour. It would therefore be unwise for a country aiming at maximum real national income to hamper the free functioning of the price mechanism and the international movement of goods through import tariffs, export subsidies or other measures which would interfere with the market process. For the purposes of our report it is relevant to draw attention to one or two inadequacies of this interpretation.

67. We have already indicated that the case for international specialisation in expanding markets on the basis of differences in comparative costs is much stronger than used to be thought because, as time goes on, the economies of specialisation in widening markets enable the most efficient producers to reduce costs further. On the other hand, we have seen that there may be conditions in which completely free international trade between industrialised and underdeveloped areas may actually tend to hamper the process of industrialisation and economic growth in the latter.

68. A further modification of the more simple analysis of international trade which is especially relevant to our terms of reference concerns the non-fulfilment in the real world of the assumption of perfect competition and the strong influence in actual practice of government policies on economic affairs. In reality, the markets for most goods are far from perfect and wages are normally fixed by collective agreements between employers' organisations and trade unions. In certain cases the government may fix prices or wages or both and over a wide field governments influence costs and prices in a variety of ways, particularly through social legislation and taxation.

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[1] In this context the "interest" of a country is to be understood in the sense of increasing its real national income.

69. While it is clear that the description of the processes of pricing and production on which the earlier interpretations of international trade are based is somewhat unrealistic, it is doubtful whether this shortcoming affects the validity of the conclusion that at least countries which have reached a comparable level of economic development can significantly raise their productivity and real incomes by engaging in freer international trade. While we cannot analyse this question in detail in the present context, we indicate below some of the reasons why we share the view [1] that the case for freer international trade remains basically unaffected by the fact that in the real world the patterns of competition and the scope and nature of government intervention in economic affairs are different from those assumed in classical theory.

70. First, while it is true that producers of many goods fix the prices of their products unilaterally, their freedom to do so is usually restricted considerably by the existence of competing producers in the same or in other countries. If "perfect competition" is rare, absolute monopoly in which a producer can for any considerable length of time fix his prices with no regard to what other producers are charging for competing products is perhaps even rarer. In the rare cases where there is no effective competition within an industry there will usually be at least some measure of competition between industries : television competes with film and spectator sports industries, book sales and even the custom of restaurants ; frozen goods compete with canned goods, soap with detergents, margarine with butter, aluminium with copper and steel, and so on.[2]

71. Secondly, many private monopolistic and restrictive business practices can be carried on only because there is protection and would disappear with the elimination of trade barriers.

72. Thirdly, turning to the influence of collective bargaining on the process of wage determination, such evidence as is available on wage movements over long periods of time in unionised and non-unionised industries seems to lead at most to the conclusion that in certain periods and under certain conditions wages in sectors where trade unions are strong have risen slightly more than in industries where the unions are relatively weak, although it appears that in times of depression wages in unionised industries have fallen

[1] See Gottfried HABERLER : "The Relevance of the Classical Theory [of international trade] in Modern Conditions", in *American Economic Review*, Vol. XLIV, No. 2, May 1954, pp. 543-551.

[2] See Ross M. ROBERTSON : "On the Changing Apparatus of Competition", ibid., pp. 51-62.

substantially less than in industries where the unions were weaker. On the whole, it seems doubtful whether in most countries the existence or absence of collective bargaining and differences in the strength of trade unions appreciably affect relative wages, patterns of production and of international trade, even when there is a measure of protection. Statistics of relative wages corroborate this opinion. In a régime of freer trade the impact of trade union policies on the relative costs of different industries and on the composition of production and international trade will, of course, be even smaller. Even in the cases where "non-competing" labour groups and monopolistic differentials affect trade, it is not evident that this is an argument for protection (see paragraphs 104 ff.).[1]

73. Government economic and social policies may undoubtedly have a considerable influence on the structure of production and therefore on the pattern of international trade. This is clear, for example, in the case of high import duties or heavy export subsidies in respect of individual commodities. Such measures lead, and are intended to lead, to the expansion or maintenance of domestic industries producing goods which might otherwise have been produced in larger quantities abroad. As we shall see in Chapter III below, heavy social charges imposed only on certain industries or exemption from social charges granted only to certain industries may lead to similar distortions in international competition and trade. Indeed, even when measures of social or economic policy are uniformly applied to all industries in a particular country, the actual effects of such measures may not be the same in all industries and the pattern of production and international trade may differ from what it would have been if such measures had not been taken. For example, if in order to stimulate investment a government allows heavy depreciation allowances for purposes of taxation during the first few years after an investment has been made, growing industries will benefit more from this measure than industries in which the rate of new investment is relatively low. The effect may be that if one country applies such measures while other countries do not, the former country may gain a significant competitive advantage in the development of new and expanding industries.

74. Government policies may even have the effect of altering the basic pattern of resources by which differences in comparative

[1] The possible influence of trade unions on the average wage level, which may affect the international competitive position of a country with fixed foreign exchange rates, is not discussed here. See paragraph 96.

cost and the pattern of international division of labour are determined. For example, when a country enacts legislation tending to reduce working hours in all industries, the effect will be a fall in the supply of labour, but also a technical change that makes the use of machinery more expensive per unit of time. The production and trade of such a country will be affected in a way which it is difficult to predict.[1] This does not, however, mean that such a country would derive less benefit from the freeing of international trade: with working hours longer and the supply of labour relatively larger in other countries, it will reap all the benefits which follow from international division of labour based on differences in the conditions of production in different countries.

75. In other cases the effects of international differences in generally applicable social policies are more complicated. In Chapter IV below we analyse, for example, the effects of international differences in methods of financing social security and welfare schemes, but there is reason to believe that as a general rule differences in social policy do not basically undermine the case for freer international trade.

76. Finally, as regards the traditional assumption of international immobility of labour and capital, as long as the free international movement of these factors is substantially restricted by government regulation (as is the case in most countries at the moment), this assumption is not too far from reality. If and as international movements of labour and capital are liberalised, the pattern of production and international trade may well be affected, because certain countries may come to have less, and others more, labour or capital than they would otherwise have. At any point of time there will, however, be a definite pattern of differences in comparative cost determined, among other things, by the relative amounts and prices of capital and labour of which various countries dispose at that time. For this reason the existence of international movements of labour and capital cannot be said to invalidate the case for freer international trade.

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[1] A related question is that of differences in overtime premium ates. The stronger the disinclination of workers to work overtime or the more severe the legal restrictions on overtime work and the less elastic, therefore, the supply of labour, the higher overtime premium rates will tend to be. International differences in overtime premium rates thus tend to reflect international differences in the elasticity of supply of labour. These differences in the elasticity of supply of labour in different countries will, of course, have certain effects on the pattern of international division of labour.

Some Cases in Which Protection May Be Advantageous

77. It should not, however, be concluded from what we have said above that we wish to advocate a régime of unqualified and unregulated free international trade. There may, indeed, be reasons why a particular country may find it necessary to continue protection of particular industries. We have already mentioned the case of underdeveloped areas in which the process of industrialisation and economic growth may have difficulty in getting under way unless special measures are taken to promote it.

78. Again, in the classical formulation of the case for freer trade, little or no attention is devoted to the possibility that a country may be suffering from unemployment. As a general rule the objective of full employment, if reasonably interpreted, would seem to be quite compatible with the objective of freer international trade, but it is not impossible that a particular country may at some time find it difficult to maintain full employment without having recourse to some measure of temporary protection. However, while it is true that protection during a depression may provide a stimulant to private investment, such protection, if continued over a long period, will distort the pattern of international division of labour. It should also be borne in mind that there are other means of combating a depression caused by a deficiency of effective demand (particularly measures of fiscal policy) which do not involve such undesirable side effects and which in most cases will be adequate for coping with problems of "cyclical" unemployment.

79. In addition to these economic arguments for protection there may be "non-economic" arguments. Countries may very well pursue other goals of policy than the maximisation of real income per head. For example, a country may feel that there are compelling reasons for protecting industries needed for national defence. Or it may have special reasons of social policy for maintaining certain types of domestic activity even when they do not constitute the most economic use of resources. Our terms of reference do not, however, require us to go into these questions.

CHAPTER III

INTERNATIONAL DIFFERENCES IN LABOUR COSTS AND THEIR IMPACT ON INTERNATIONAL TRADE

80. There is a widespread feeling that closer economic co-operation in Europe should not be allowed to expose particular industries to artificial competition from abroad, and that competition from countries with lower labour standards may be "unfair". We examine this question in the present chapter. We first quote certain facts and statistics illustrating the prevailing differences in wages and other conditions of employment in a number of European countries, and then proceed to discuss the significance of these differences, addressing ourselves, in particular, to the question whether the existence of these differences would create special difficulties for certain countries in a régime of freer intra-European trade. In Chapter IV we shall examine the questions whether the existence of these differences makes it desirable that certain steps to "harmonise" social conditions and social policies be taken concurrently with the establishment of a régime of freer trade in Europe; and, if so, what measures of "harmonisation" might, in appropriate cases, be recommended.

Some Facts and Statistics

81. There are substantial differences in wage payments and in other elements of labour cost (such as social charges) per hour among the various countries in Europe. These are illustrated in the first column of table I which brings together, for purposes of rough comparison, statistics of average hourly earnings in manufacturing in a number of European countries, converted into Swiss francs.

82. The differences in average earnings on this basis should not be considered to measure real wages, since exchange rates cannot be assumed to reflect the purchasing power of currencies.[1] Owing to

[1] The use of exchange rates to express wages in a common currency is, of course, justified for purposes of analysis of costs of production in different countries.

trade restrictions and price controls within various countries, differences in the values of currencies on the world market may not reflect differences in the domestic purchasing power of the same currencies. Moreover, workers' real incomes include in most countries benefits, the cost of which is borne by the national community as a whole ; examples are low-cost housing, vocational training and cheap transport.

TABLE I.

AVERAGE HOURLY EARNINGS, OBLIGATORY SOCIAL CHARGES AND COST OF DAYS OFF WITH PAY IN MANUFACTURING IN EUROPE [1]

Country	Average hourly earnings, 1954		Obligatory social charges expressed as percentage of assessable wages at 1 Jan. 1956	Cost to employers of days off with pay as percentage of wages, 1952-53.	Wages plus obligatory social charges plus cost of days off with pay. Indices : Switzerland = 100
	In Swiss francs	Indices, Switzerland = 100			
Sweden .	3.33	130	2.2	6.0	128
Finland .	2.81	110	6.0	4.5	111
Denmark .	2.67 [2]	104	7.5 [6]	6.5	108
Norway. .	2.58	101	3.7	6.0	101
Switzerland	2.56	100	3.9	6.0	100
United Kingdom	2.26	88	2.7	6.0	88
Belgium .	1.91 [3]	75	17.7	11.6	88
France . .	1.88 [4]	73	29.8	7.2	92
Germany (Fed. Rep.)	1.74	68	11.7	9.8	75
Ireland . .	1.53	60	1.7	4.6	58
Netherlands	1.38	54	19.0 [7]	7.2	62
Austria . .	1.30 [5]	51	19.0	10.1	60
Italy . . .	1.22	48	53.5	14.2	73

Sources:

For *wage data*: I.L.O. : *Year Book of Labour Statistics 1955* (Geneva, 1955) and I.L.O. files. Figures converted into Swiss francs at clearing rates shown in *Annuaire statistique de la Suisse* 1954 (Berne, Bureau fédéral de statistique).

For *obligatory social charges as percentage of assessable wages*: Sum of employer contribution rates as of 1 January 1956 for old age, sickness, employment injury, unemployment, and family allowances, based on replies to I.L.O. questionnaire. In a few cases the rate for one or more of the social security funds is that in force at an earlier date.

For *cost of days off with pay* : " Les charges sociales dans les pays de l'O.E.C.E. " in *Études et Conjoncture* (Paris, Presse universitaire de France). Ninth year, No. 3, Mar. 1954, pp. 269-284.

[1] As the figures for hourly earnings, obligatory social charges, and days off with pay relate to different dates, the aggregate figures in the final column, which have been computed by the I.L.O., are no more than rough approximations. It is considered unlikely, however, that their relative magnitude is affected in any substantial degree by the difference in the dates to which the three sets of data relate. [2] Average of first three quarters : general level of wages. [3] June. [4] September : general level of wages. [5] Vienna. Interpolated on basis of weekly earnings. [6] Estimated. [7] Maximum rate of contribution.

83. In Appendix I, prepared by the International Labour Office, attention is drawn to a number of qualifications and reservations that need to be borne in mind in interpreting these statistics. It is, however, clear that producers in the various countries, trading

competitively on any common market, would have substantially different wage costs per man-hour of work. In general, wages are highest in the Scandinavian countries and in Switzerland, and lowest, among the countries shown, in Italy, Austria and the Netherlands. The extent to which these differences imply differences in costs per unit of output depends, of course, on comparative levels of productivity in the various countries.

84. It is also of interest to inquire whether there are important differences between countries in the spread of wages in different manufacturing industries above and below the average, and in the relationship between average wages in manufacturing and in other sectors, for example agriculture. Tables A to D in Appendix I show that, though there are rather substantial differences in the inter-industrial patterns of wages, particularly as between agriculture and industry, there is also a definite general similarity among the various national wage patterns. For example, in all countries agricultural money wages [1] are lower than wages in industry and in practically all cases wages in mining, quarrying, metals and engineering are substantially higher than in textiles and other light industries. Furthermore, in recent years there has been a tendency for wage differentials, both between industries and between male and female workers, to become narrower.

85. Though usually by far the most considerable, wages are by no means the only element in labour cost. With the growth of trade unionism and the extension of social legislation in the various European countries, the social charges which represent the cost of social programmes to employers have increased. Any international comparison of labour costs must be based not on wages alone but on wages and social charges taken together.

86. Unfortunately, reliable comparisons of the cost to employers of the social charges imposed or voluntarily incurred in the different countries are extremely difficult to make. These difficulties are discussed in Appendix I, in which the International Labour Office has made an effort to establish international comparisons of the cost of social security programmes and of days off with pay. These comparisons, as is pointed out, are by no means exact, and there are certain other social charges in respect of which no worth-while international comparison can as yet be made.

[1] In most cases real wages in agriculture are substantially higher, compared with those in other industries, than relative money wages would suggest.

87. It is clear that since not all social charges can be measured, and since even for those items for which estimates can be made the estimates are rough and inaccurate, any attempt to add wages and social charges and compare the combined figures for different countries can give only a very rough approximation. However, allowing boldness to prevail over caution, we do show in the final column of table I how the wage comparisons presented in the first two columns of that table would be affected if these wage data were augmented by percentages, based upon tables E and G in Appendix I, representing estimates of the cost to employers of obligatory social charges and days off with pay.

88. The data strongly suggest that social charges are highest in countries with relatively low money wages. Thus employers in the three lowest-wage countries (Italy, Austria and the Netherlands) and in Belgium and France, where median wages are paid, appear to pay the highest social charges, while employers' social charges in the Scandinavian countries and Switzerland are moderate to low. The spread between the highest and lowest wages is appreciably reduced when social charges are taken into account.

89. Accurate comparisons of the levels of wages and social charges in different countries must await an authoritative study which will set forth clear definitions and be based on new and improved data. In this connection we await with interest the outcome of an investigation into wages and related elements of labour cost in Europe currently being undertaken by the I.L.O., with the co-operation of a number of European governments, along lines agreed upon at the meeting of statistical experts convened by the Governing Body in May 1955.

90. There are, however, two very important points to be borne in mind when interpreting any statistical comparisons that may be attempted in this field. First, there are great differences between countries in the methods of financing social benefits. When these are financed largely out of general revenue, as in the Scandinavian countries and the United Kingdom, employers' contributions appear low. But employers, in common with other sections of the community, contribute to general revenue through taxation which is not specifically earmarked for social services. This does not appear in the statistical comparisons in table I.[1]

[1] We return to this question in Chapter IV.

91. Secondly, the total of wages and social charges in relation to selling prices is evidently, in some countries, considerably higher than wages alone, but it is not necessarily higher than it would have been if there had been no social charges at all. It is a familiar notion that the actual burden of a tax is often shifted, in whole or in part, through changes in prices, away from the person or group on whom the tax is originally levied to other persons or groups. For example, an excise duty on whisky may be imposed on, and collected from, the distillers, but if the price of whisky rises by the full amount of the tax it is the consumers and not the distillers of whisky who actually bear the burden. The burden of social charges imposed on and collected from employers or workers may also be shifted. The burden of social charges imposed in the first place on employers may be shifted to consumers in the form of higher prices, or to workers in the form of a retardation of wage increases. The burden of social charges imposed in the first place on workers may, at least to some extent, be shifted to employers in the form of higher wages to compensate the workers for the deduction of social contributions from their earnings, and perhaps in turn may then be shifted from employers to consumers in the form of higher prices. It has in fact been contended that "the distinction between the employers' contribution and that of the workpeople is a fiction".[1]

92. As in the case of taxes, it is probable that the burden of any particular social charge tends for a time to stick where it falls, owing to a certain rigidity in prices and wage contracts. But, especially with the passage of time and as output and wages increase, opportunities for shifting the burden will arise. These opportunities will be greater in some cases than in others, the outcome depending upon the elasticity of supply and demand at the different stages of production and distribution, as affected, *inter alia*, by the strength of trade unions and employers' organisations, as well as of other organised interests (for example, farmers' organisations), by the exact nature of the tax or levy and by the technical conditions of production of various goods. Since the possibility of shifting the burden is larger for some commodities than for others, the composition of demand, production and foreign trade of the economy as a whole will be affected : some goods will be produced in larger, others in smaller volume than would have been

[1] R. G. Hawtrey : *Cross-Purposes in Wage Policy* (London, Longmans, Green and Co., 1955), p. 107.

the case if no social charges, or different types of social charges, had been applied. It is, however, in most cases, extremely difficult to determine what is the ultimate incidence of any tax or social charge, i.e. the difference between the actual distribution of income and composition of output and employment and those which would have existed if the tax or social charge in question had not been imposed. The analysis cannot be pursued here, but it is clear that this sort of shifting is no mere theoretical curiosity but is a phenomenon with important practical consequences. [1]

93. In some cases the shifts in incidence are clearly visible because they are explicitly provided for. For example, under the post-war system of wage determination in the Netherlands, under which wages are fixed by the Board of Government Conciliators on the basis of general directives from the Government, a decision to raise the general level of wages has been accompanied on various occasions by decisions regarding the increases in prices considered necessary and permissible. Also, the introduction of the general unemployment scheme in 1952 was accompanied by a general wage increase to compensate for workers' compulsory contributions to the scheme. [2] Usually such shifts are less clearly visible, but the fact that, as our figures have shown, wages tend to be low in the countries in which social charges imposed upon employers are high strongly suggests that some part at least of the burden of social charges imposed upon employers has in fact been shifted to workers in the form of a retardation of wage increases which they would otherwise have been able to secure. [3] Wages and the various social benefits financed by means of social charges are closely related elements in workers' living standards and in employers' costs of production, and improvements secured for workers in any one direction may often make it harder to secure simultaneous improvements in other directions.

[1] A special case occurs when improved conditions of work and higher remuneration lead to an increase in the productivity of labour, thus creating, in effect, the resources out of which their cost can be financed.

[2] This does not, of course, mean that in such cases the workers do not ultimately assume some part, or even the whole, of the burden involved. Through secondary changes in prices or perhaps through retardation in further money wage increases which might otherwise have been possible, workers may very well, in the final incidence, come to bear all or part of the cost of the scheme.

[3] "It is interesting to note, for instance, that the percentage share of wages in the national income of France decreased between 1938 and 1950 by an amount corresponding to the increase in taxes on wages paid by employers." (United Nations: *Economic Bulletin for Europe*, Vol. 4, No. 2, Geneva, Aug. 1952, p. 46, footnote 3.)

Implications for International Trade

94. We return now to the questions whether the existence of these differences in wages and social charges would create special difficulties for certain countries in a régime of freer intra-European trade, and whether some "harmonisation" of social conditions and social policies is necessary before or at the time of the establishment of greater freedom of trade.

International Differences in General Levels of Wages and Social Charges

95. Under conditions of well-balanced international economic relations, differences in the general level of wages (and social charges) in different countries on the whole reflect differences in productivity. The best evidence of this is the fact that high-wage countries have in fact been able to export enough to pay for their imports. Monopolistic factors on the labour and commodity markets—for example, relatively high wages in home market industries in some countries—may, however, affect the relation between average national wage levels at given levels of productivity ; and under conditions of freer trade the relative levels of wages and productivity in different countries would be different from what they are at present.

96. In considering the mechanism by which international equilibrium is reached it is well to remember that exchange rates between currencies tend to be adjusted to the different price and cost levels prevailing in different countries in such a way that each country can specialise in the production and export of certain commodities and that the balance of international payments is approximately maintained. Persistent difficulties in exporting enough to pay for imports usually lead to adjustments of cost levels or exchange rates to restore equilibrium in international payments. If in any one country or group of countries the general level of costs is, for any reason, temporarily too high for those countries to be able to pay their way, strong economic forces are brought into operation to put an end to this state of affairs. Balance-of-payments deficits cannot continue for longer than reserves of gold and foreign exchange hold out. In practice, when these reserves have been falling over a period of time, the country concerned will be led to take measures of credit or fiscal policy to bring about an adjustment in its level of

money costs and prices, for instance by keeping its own level fairly constant while costs and prices rise abroad. A relatively rapid increase in productivity or an expansion of export industries may also help to restore the balance (see paragraph 127). When a country fails to take such measures and instead has recourse to import restrictions, or when, as a result of action by manufacturers or trade unions, the effect of such measures is too small and costs and prices rise again, the real cause of the difficulties is not that, for example, labour costs abroad are "too low" but that those within the country itself are allowed to remain "too high" in relation to the country's over-all productivity.

97. When there is a lack of balance in the internal economy, with inflationary pressure, a tendency to over-full employment exists. The natural remedy is to attempt to restore the economic balance. In the opposite case, when the lack of balance takes the form of deflationary pressure and underemployment, the natural remedy is a policy of expansion.

98. The equilibrium in the balance of payments which is considered above is one which is compatible with full employment in the long run. The mechanism of maintenance or restoration of balance may be assisted by the influence of international capital movements. In some cases the maintenance of equilibrium at a particular level of exchange rates may be dependent in large measure on such movements of capital.

99. Leaving aside temporary problems of disequilibrium in international payments, it is clear that in a fairly balanced international economy considerable international differences in the general level of wages and social charges will exist. Such differences, even when they are much greater than those prevailing in Europe, can scarcely create lasting difficulties for the high-wage countries when their economies are considered as a whole.

100. The compensating advantages which the high-wage countries possess are familiar. They include such advantages as rich natural resources, relatively abundant capital equipment, relatively efficient entrepreneurship and management, and trained, experienced and efficient labour. The most convincing illustration of the importance of these advantages is the fact that the United States, paying the highest wages in the world, has shown such a persistent tendency to export more than it imports and to add to its gold reserves. The fact that the whole world has suffered from

a serious "dollar shortage" since, and to some extent even before, the war demonstrates the falsity of the view that, if the level of wages in a country is high, this will make it impossible for that country to compete effectively with low-wage countries.

101. All this is not to say that particular industries and undertakings in high-wage countries, and the workers employed in these industries and undertakings, will not experience difficulties if they are exposed to freer competition from abroad. But the high-wage countries are in no different position from other countries in this respect. In all countries there are a certain number of industries and undertakings which, at any time, are only just, or not quite, profitable. Such marginal industries and undertakings are, so far as we know, not less numerous, in proportion to others, in low-wage countries than in high-wage countries. It is these marginal industries and undertakings in all countries which, unless they can increase their productivity, will face the prospect of having to contract or go out of business if a régime of freer trade is instituted, and to whose problems we devote special attention in the next chapter.

102. The marginal industries and undertakings in high-wage countries will be those which, for one reason or another, do not share in the general advantages and efficiency which have enabled their countries to become high-wage countries. Manufacturers of watches and bicycles in the United States appear to be cases in point. To them it may seem that their troubles are due to low wages in competing countries. But the fact that the United States has no difficulty in balancing its international payments is clear evidence that producers in that country who experience special difficulties in competing with foreigners are in most cases either relatively less efficient than other American industries or are producing things which their country is not well suited to produce, for instance because a large quantity of experienced labour is required for such production. The same is true of producers experiencing similar special difficulties in other high-wage countries.

103. It follows from the foregoing analysis that, so long as we confine our attention to international differences in the general level of costs per unit of labour time, we do not consider it necessary or practicable that special measures to "harmonise" social policies or social conditions should precede or accompany measures to promote greater freedom of international trade. Nobody would suggest that

wages and social benefits in the watch-making and bicycle industries in countries competing with the United States ought to be raised to a level out of line with wages and social benefits in other industries in those countries. But if one could imagine that the general level of wages and social benefits in the rest of the world were raised sufficiently to enable American manufacturers of watches and bicycles to compete freely with the more efficient foreign producers, the rest of the world would stand no chance of competing in the wide range of goods which, as things are, the United States can sell without difficulty. Other countries would run rapidly through their gold and dollar reserves, and there would be balance-of-payments crises throughout the world. These considerations suggest that the remedy for the kind of situation under discussion is not to raise foreign wages but either to find other and more productive employment for the resources employed by producers encountering special competitive difficulties, or (if considered justifiable on social or strategic as distinct from strictly economic grounds) to provide special protection for such producers. [1]

International Differences in Wage Structures

104. The case is different if the foreign competition to which a particular group of producers is exposed (or would be exposed under freer trade) arises not because the general level of wages in the competing country is low but because foreign producers in the same line of business pay wages and have to bear social charges which are exceptionally low in comparison with other wages and social benefits in the same country, when reasonable allowance has been made for such factors as differences in skill, in the arduousness

[1] The analysis in this section sets forth briefly the principle that equilibrium in international trade can be achieved even when international differences in remuneration, costs, tariffs and taxation exist.

It should, however, be borne in mind that the equilibrium rates of exchange are affected by a number of circumstances other than international differences in labour remuneration and productivity, including the degree of monopoly and variations in a country's economic structure. For example—

(1) In a protected economy in which the level of wages has been influenced by the action of trade unions or the Government, the removal of trade barriers will probably reduce the power of unions or the Government to vary the level of wages and costs and this will be reflected in the rate of exchange which will be appropriate after the elimination of customs duties.

(2) In the long run the economic structure of a country may change as a result, for example, of changes in the availability of capital; these changes will affect the pattern of international specialisation; and each pattern of production and international trade may involve a different equilibrium rate of exchange.

and responsibility of the work, in conditions of employment and in costs of living, and for the normal differentials in wages which accompany differences in the rates of growth of various industries.

105. If there were no differences in the general level of wages and social charges borne by employers in countries A and B, but if, to take an example at random, manufacturers of fountain pens in B paid wages and social charges at substantially lower rates than those paid for comparable work in other industries in B, the manufacturers of fountain pens in B would have an artificial competitive advantage compared with pen manufacturers in A. It is clear that the payment of substandard wages and social benefits in this sense could have lasting effects on international competitive relations in the industry concerned, and could distort the pattern of production and international trade. [1] It should, however, be borne in mind that similar distortions are often caused by other elements in government policies (such as taxation) and in cost structures (for example, freight rates) which may justify special treatment of employers in certain industries as regards the payment of social charges (as distinct from the social benefits to which their workers are entitled). We return to this question in Chapter IV.

106. It is, of course, true that A, if it could count on continuing to receive cheap fountain pens from B, would benefit by admitting them freely and finding alternative employment for those of its resources which had hitherto been engaged in making the same commodity. However, in the circumstances described above, this would involve a heavy and unjust sacrifice on the part of employers and workers in A's fountain pen industry. Hence there would be a good case for measures of "harmonisation", in the sense of measures to bring wages and social conditions in B's fountain pen industry into line with those in other industries in B, before A could reason-

[1] It may be argued that misallocation of resources due to significant differences in the remuneration of labour in different sectors of the economy can be to the disadvantage of countries indulging in this type of "unfair competition" as well as of countries which are subject to it. In areas where wages in agriculture are very low compared with those in non-agricultural employment, industrialisation will tend to be held up as a result of the comparative advantage enjoyed by agriculture. Even without foreign trade, domestic capital and labour will be absorbed by agriculture to a larger extent than if that industry had not in effect been subsidised, at the expense of labour, by substandard wages. When there is foreign trade the rate of exchange which ensures equilibrium in the balance of payments will be such that, while agriculture holds a relatively strong position in international markets, foreign competition in other fields will hamper the development of manufacturing and other industries.

ably be expected to admit B's pens freely to its markets. This was certainly the view which the Randall Commission in the United States expressed in the following terms :

> Neither low wages nor low unit labour costs, in and of themselves, constitute "unfair competition". The clearest case of unfair competition is one in which the workers on a particular commodity are paid wages well below accepted standards in the exporting country. In such cases our negotiators should simply make clear that no tariff concessions will be granted on products made by workers receiving wages which are substandard in the exporting country. [1]

107. It is, of course, very difficult to assess at all precisely what allowances it would be reasonable to make for the various factors which have to be taken into account in deciding whether wages and social benefits are or are not "substandard" in any particular case. Moreover, growing industries, which have to attract labour and which are in a position to let their workers share in the prosperity which usually accompanies growth, normally pay wages and other benefits which are higher than those in less rapidly expanding or declining industries. As a result a particular industry may rank as a relatively high-wage industry in countries where it is strong and well-established but as a low or average wage industry in other countries where it is less developed. For example, in 1949 hourly wages in the chemical industry in Belgium were 106 per cent. of average industrial wages in that country ; the corresponding index for Western Germany was 108, for Norway 109, for Switzerland 105, but for Denmark it was only 92, for Sweden 99 and for the United Kingdom 98. [2] Thus, in many cases relatively low wages are a result of the relatively less developed state of the industry in question rather than a cause of rapid growth based on low labour costs. This is a normal feature of the process of economic growth which involves a continuous reallocation of labour and other resources as between different industries.

108. A study of the statistical material which is given in Appendix I strongly suggests that, so far at least as manufacturing industry is concerned, differences in the general level of wages are much more important in Europe than differences in the inter-industrial wage pattern. In table I on p. 33 the range of variation

[1] Commission on Foreign Economic Policy : *Report to the President and the Congress* (Washington, U.S. Government Printing Office, Jan. 1954), p. 62.

[2] Bertil OHLIN : *La Politique du Commerce Extérieur* (Paris, Dunod, 1955), p. 56.

is much greater than in table A of Appendix I. Moreover, as has been observed, there is some similarity between countries in the pattern of variation revealed in table A. There is also considerable similarity between countries in the ratio between agricultural and industrial money wages, the former ranging from 56 per cent. to 75 per cent. of the latter in all the countries shown in table B. As we have observed above, differences in real wages between agriculture and industry are certainly smaller. Moreover, in several countries employment in industry is expanding more than in agriculture. The fact that money wages are lower in agriculture than in industry does not necessarily mean, therefore, that agricultural wages are "substandard".

109. The effect of adding social charges to wages is probably to reduce the range of inter-country variations to a greater extent than the range of inter-industry variation within each country. The latter, however, would probably also be reduced to some extent, since social benefits are probably, on the whole, more uniform in different industries in the same country than are wages.

110. A study of the figures for labour remuneration in different industries suggests that cases in which freer trade between European countries would give rise to a serious distortion of competition as a result of inter-industrial differences in labour cost per unit of time and in which special measures of "harmonisation" would be called for, are not numerous.

CHAPTER IV

PROBLEMS OF TRANSITION TO A RÉGIME OF FREER TRADE

111. In this chapter we discuss some questions related to what probably is the most important obstacle to the freeing of international trade. This is the fear that such liberalisation may adversely affect incomes, security of employment and productive wealth in industries exposed to more vigorous competition from abroad.

112. The extent to which such adverse effects might occur is often exaggerated as a result of a failure to allow for the more rapid economic growth that is to be expected in a wider market. In a progressive economy much of the adjustment to trade liberalisation will take the form of more rapid expansion of those firms that will benefit directly from trade liberalisation. Firms or industries that are adversely affected may merely fail to secure the same share in an expanding market and may not experience any decline in absolute terms in output or employment. In some groups of industries, moreover, it is quite possible for the individual firm to switch to new products without making any major change in its equipment or labour force ; it may merely discontinue or reduce its output of products which, as a result of trade liberalisation, are less able to compete with those of another country and expand instead its output of products with which it can compete more successfully. As has been demonstrated in the post-war conversion of some defence plants, such a change may not require much new equipment or the hiring of workers with skills different from those formerly employed. Nevertheless, in spite of all these qualifications there does remain the likelihood that some firms, as a result of trade liberalisation, will face contracting markets and have to reduce their total ouptut and employment.

113. This is a real problem. The essential purpose of freer international trade, at least from an economic point of view, is precisely to bring about a more effective use of productive resources. This must involve some changes in the distribution of production between countries. This means, however, that certain areas in

which labour and capital were hitherto employed in the production of certain goods will have to contract or perhaps even to abandon these lines of production, once a common market has been established, because the same goods can be produced more cheaply in some other country. The firms concerned may not always be able to switch successfully to other lines of production. Entrepreneurs and wage earners who fear they might be adversely affected by such shifts in the pattern of international specialisation, while they might concede that these changes are in the long-run interest of the community as a whole, will naturally feel concerned about the more immediate and, to them, more tangible harmful effect which liberalisation might have on their own employment and income. They will consequently oppose liberalisation.

114. Such opposition is often effective, since the groups concerned are frequently well organised in trade or manufacturers' associations, trade unions, or political parties which are in a position to bring pressure to bear on the authorities in charge of their country's foreign economic policy. The interests of the general public or the consumers, who stand to benefit from the lower costs and prices and the higher real incomes which would result from trade liberalisation, are normally far more weakly organised. As a result, the local or group disadvantages which might result from freer trade tend to carry more weight, compared with the positive advantages of a better international division of labour, than an objective appraisal of the gains and losses involved would warrant. This is a reality which practical policies for trade liberalisation must take into account.

115. This does not, however, mean that the local hardships associated with a transition from the present system of protected national markets to a freer international market would not be genuine and serious if nothing were done to mitigate them. Programmes for trade liberalisation should be implemented in such a way as to mitigate these hardships and losses to the greatest possible extent without preventing progress toward a better allocation of resources.

116. This is desirable, in the first place, for reasons of equity. Protected industries are not necessarily technically inefficient, operated by incompetent managers or manned by a parasitic labour force. In many cases protective tariffs were introduced long ago because at the time governments wished to foster the development of particular industries for reasons of defence, the balance of

payments or employment policy. If these or similar reasons have now lost most of their importance, and if it is now found desirable to do away with the tariffs, it is no more than elementary social justice that those who, for reasons beyond their control, may lose their jobs or have to abandon the plant which they may have operated for a long time with great technical skill and effort, should be given some sort of assistance in overcoming the difficulties they face.

117. Secondly, the community as a whole stands to benefit from a policy of economic integration which minimises the losses of existing productive equipment and technical skills. Although certain industries in certain countries will inevitably have to contract or may have to disappear altogether, and although in such cases it is desirable not to replace equipment as it wears out or renew the labour force as it gradually retires, these are merely the negative counterparts of the positive advantages of freer trade which arise through the utilisation of labour and capital on the more efficient scale and with the more intensive specialisation which wider markets make possible. The losses to firms or industries that are not large enough to operate efficiently or that are not sufficiently specialised will in the long run be more than offset by the rise in output in the economy as a whole. But the transfer of productive resources from one industry to another can only take place gradually. Apart from the very important social aspects of unemployment, it is better even on purely economic grounds that, until such time as sufficient opportunities for new productive employment are created, resources should remain at work wherever their output covers prime costs rather than that they should be unemployed.

118. In the following pages we discuss two questions. First, in order to place the problems of transition in their proper perspective, we consider the nature and probable order of magnitude of shifts in trade, production and employment which the establishment of a common market might entail. Secondly, we consider briefly what can be done through appropriate transitional policies to mitigate harmful effects of trade liberalisation.

Shifts in the Pattern of Trade, Production and Employment

119. It is clearly impossible to predict the shifts in production and trade which would take place, if, for example, a customs union

were set up among a number of European countries. It may, however, be useful to analyse briefly some of the factors by which these shifts would be determined. Such an analysis will help to provide a rough estimate of a least the order of magnitude of these shifts and, accordingly, of the problems of changes in employment and investment that are involved.

120. Let us assume that a group of countries decide to set up a customs union of the type envisaged in the Charter for an International Trade Organisation and in the General Agreement on Tariffs and Trade. This would mean that import duties and other restrictive regulations of commerce between the participating countries would be abolished and that the duties and other restrictions on trade applied by the participating countries in their trade with third countries would be substantially uniform, the incidence of these restrictions being on the whole not higher or more severe than that of the restrictions applied in the constituent territories prior to the formation of the union. What will this mean, in terms of shifts in trade, to any individual participating country?

121. First, prices of goods which can be imported from other participating countries will tend to fall. The higher the old tariffs were, the greater (other things being equal) this fall in prices will tend to be and the more imports of the goods in question will tend to increase. In many cases the fall in prices will at first be smaller than the amount of the duty, because foreign producers will not be able to expand output immediately at constant costs. In the longer run the expansion of output and increased specialisation of foreign producers may lead in some cases to lower costs of production, and prices may fall further than would correspond to the level of the original duty. In other cases this may not be possible.

122. Secondly, the abolition of quantitative restrictions on imports from other participating countries will similarly lead to an increase in the supply of foreign goods, which will to a greater or less extent replace domestic goods.

123. Thirdly, because tariffs continue to be levied on imports from outside countries but not on those from partner countries, part of our country's imports from third countries may be replaced by imports from partner countries.

124. Fourthly, for the same three reasons distinguished above, which will operate in other countries too, our country will be able

to expand exports of a number of commodities to the other participating countries.

125. Briefly, our country will import more. Some of these imports will tend to replace some domestically produced goods. The industries which formerly produced these goods may concentrate instead on making longer runs of other items for the wider market or may switch to making other products ; but in some cases there will be a slackening in the rate of growth in these industries or even a contraction in their total output and employment. On the other hand, the country will also increase its exports, thereby replacing some production for internal use in other partner countries or some exports from those countries or from outside countries ; this will lead to an expansion of domestic output and employment in the country we are considering. On balance, there is a shift in the proportions of domestic production for internal use and for exports. This shift constitutes the problem of transition.

126. How large will the shifts in imports and exports be? A first observation which may be made on this question is that the increase in the value of imports cannot, in most cases, be very much larger or smaller than the increase in the value of exports. Otherwise, as we have seen in Chapter II, a deficit (or surplus) in the balance of payments would arise which, since there is no longer any possibility of applying import duties or quantitative restrictions on trade between participating countries, may be matched by an adjustment of the country's level of internal costs compared with that in other countries or else may call for a revision of the country's exchange rates. The requirement of a rough balance between the increases in the value of imports and exports does not, of course, imply that the increase in exports will create a volume of employment in the production of exports which will exactly match the fall in employment in production for domestic use which will result from the replacement of some domestic production by additional imports. But it does mean that there is an inherent limit to the extent to which imports might rise and employment in competing domestic industries fall when a common market is established.

127. In most cases a large part of the adjustment necessary in high-tariff countries to avoid deterioration in their balances of payments could be brought about through a fall in relative costs and prices without a revision of exchange rates. If high tariffs are gradually reduced, the relative level of prices and living costs in these countries will fall more rapidly, or rise less fast, than those

in low-tariff countries. As a result real wages in the high-tariff countries will rise even though money wages may be kept constant or rise less than in other countries. In the course of a fairly long period of transition quite substantial changes in relative price levels could come about in this way without there being any need to reduce the absolute level of money wages. There may also be possibilities of achieving balance-of-payments equilibrium by measures to encourage investment in export industries. As we have noted already, the wider market opened up by freer trade will provide many opportunities for more intensive specialisation and mass production ; and these opportunities will greatly facilitate the process of adaptation in industries which in the smaller markets at present available can survive only with the aid of tariffs. Should neither of these methods suffice to bring about the necessary changes in relative costs and prices, recourse might be had to some revision of exchange rates. Substantial adjustments in relative levels of costs and prices might be achieved without any formal devaluation by introducing a system of flexible exchange rates which would permit fluctuations, larger than at present, on either side of the fixed parities. Should it prove impossible to adopt such a system, or should the fluctuations permitted thereunder not prove adequate to solve the problem, a change in the external value of the currency would become inevitable. But such a change need not cause any serious rise in the domestic price level : the higher price of foreign currencies would be matched to a large extent by a fall in the domestic prices of foreign goods through the elimination of tariffs and quantitative restrictions.

128. Thus there are various ways in which countries with a high average level of tariffs could adjust their relative levels of costs and prices and thereby safeguard their over-all competitive position and avoid any deterioration in their balances of payments when tariffs are reduced. The problems of transition to a régime of freer trade may thus not be much more difficult for high-tariff countries than for low-tariff countries. The magnitude of these problems will depend on the extent of the shift in demand from domestic output to imports of the goods concerned. An important question therefore is that of the degree to which buyers tend to shift from domestic products to imports when the prices of the latter fall. A second important question is how far producers can adjust their costs of production to such price changes.

129. As regards the first of these questions, it should not be

assumed that if, for example, France and Germany were to abolish import duties on cars and if, as a result, foreign cars could be bought more cheaply than before in each country, either Germans or Frenchmen would stop buying domestically produced cars. Some, who otherwise would have bought a domestically produced car, would decide to have a foreign one but others would not. The net effect on each country's total sales of its own cars is uncertain but there is reason to believe that any change in the total demand for its cars and, consequently, in production and employment in the industry, would be smaller than is often thought. There are various grounds for this belief. One is that goods, and especially consumer goods, are not identical even when they are quite similar. Many consumers, once they are accustomed to particular brands, or have formed an opinion about them, will not abandon them when a somewhat cheaper product becomes available. This phenomenon, which is quite important also with regard to the competition between similar products produced within the same country, is based on real or imaginary differences in quality which in the consumer's opinion justify the higher price of more expensive products. As far as international competition is concerned, consumers' preferences may further be influenced by a tendency systematically to rate goods produced in their own country higher than commodities made abroad. This may sometimes be mere chauvinism, but in other cases it may be based on the better adjustment of locally made goods to local tastes and preferences. In addition, there are often technical reasons why the availability of cheaper foreign products may not lead to a very substantial shift in demand. For example, maintenance and repair services may be less adequate and delivery times longer in the case of foreign products than for goods made in the country itself. Furthermore, the whole organisation of wholesale and retail commerce is often somewhat sluggish in adjusting to changes in relative prices. There are established channels and contacts between producers and dealers ; these can of course be changed, but experience shows that, unless price differences become rather large, this will not happen to any great extent. Again, in spite of modern means of communication, domestic suppliers can be contacted more easily, they have the advantage of speaking the same language and using the same measures as the customers, and so on.

130. The result of all this is that although the liberalisation of trade will involve, and is intended to involve, substantial shifts in

production and employment, these changes will probably be far less great or sudden than is often thought. Exactly how large the shifts will be it is impossible to say, but readers will be interested in the estimates which one of the members of the group has made of the changes in the volume and composition of trade which might occur if a customs union were established between ten European countries. These estimates are given in Appendix III.

131. In these estimates account is taken only of the direct effects of the elimination of import duties, but there will in addition be indirect effects which will further reduce the seriousness of problems of transition. On the one hand freer trade is likely to lead to a rise in incomes and in demand for materials and other goods. Domestic producers as well as exporters will both share in this growth in demand in any country. On the other hand many producers will find it possible to reduce their costs through an improvement in productivity. There certainly are large reserves of potential increases in productivity which have hitherto not been exploited because protection makes it less urgent for manufacturers and other producers to seek and apply the best possible methods of organisation and work.

132. Finally, it should be mentioned that the general economic climate is favourable to the effecting of changes in patterns of production and employment when many countries have reached a stage of full employment and dispose of the means to maintain full employment.

Trade Liberalisation in Steps

133. The most obvious method of mitigating the hardships involved in the abolition of trade barriers is to proceed gradually with measures for such liberalisation. All industrial countries have for a long time been going through a continuing process of gradual change in the structure of their production and employment in response to technical and economic progress. They have thus managed to bring about startling shifts in their whole economic structure (far larger than could ever be expected to result from the liberalisation of trade), gradually adapting costs, prices and production methods to new opportunities, while abandoning lines and methods of production which have become obsolete. This, indeed, is essentially what happens when productivity is increasing. Practical experience has shown that the gradual shifting of patterns

of production and employment can take place without causing any major upheavals precisely because it is a gradual process, which the modern industrial economy is quite capable of absorbing smoothly. A similar process of gradual adaptation to new and more productive activities without causing heavy unemployment or undue distress should also be possible when obstacles to freer trade are being abolished. During the period of transition capital and labour could gradually move out of contracting industries and into the types of activity which get opportunities to expand. More precisely, if an economy is able to maintain rising output and employment, a gradual adjustment would require not so much a physical movement of capital or labour from one firm or industry to another as changes in the composition of output (or "product mix") within firms or industries, increasing concentration on longer runs of particular items, and the movement of new capital and new entrants to the labour market into the expanding rather than the contracting firms or industries.

134. Provision for implementing a customs union in steps is made in the General Agreement on Tariffs and Trade, which provides that exemptions from certain obligations under the Agreement (especially that of most-favoured-nation treatment under Article I) can be permitted not only in respect of customs unions but also for an interim agreement leading to the formation of a customs union, provided that such an interim agreement "shall include a plan and schedule for the formation of such a customs union... within a reasonable length of time" (Article XXIV, 5 *(c)*). [1]

135. Plans for the gradual reduction of tariffs on a non-preferential basis have been put forward in recent years, including the scheme for a "low-tariff club" sponsored by the Council of Europe and calling for a gradual reduction in tariffs on raw materials, semi-manufactured goods and agricultural products to 5, 15 and 25 per cent. respectively, and the Pflimlin Plan which provided for a general 30 per cent. reduction in tariffs over a period of three years.

136. The principle of gradualness has actually been applied within the framework of the European Coal and Steel Community.

[1] The requirement of a "plan and schedule" is, of course, designed to ensure that plans for a customs union do not degenerate into new systems of discriminatory or preferential tariffs which would be in conflict with the basic philosophy of the Agreement.

For example, an interesting provision of the Convention concerning transitional measures (*Convention relative aux dispositions transitoires*, section 26) defines the maximum fall in coal output in Belgium from year to year as follows :

(*a*) if total coal production in the Community as a whole does not fall, output in Belgium should not have to be reduced by more than 3 per cent. compared with the preceding year ; and

(*b*) if total output in the Community does fall, Belgian production should not have to fall by an amount larger than that which would reduce Belgium's proportionate share in the (falling) total production of the Community to 97 per cent. of that share during the preceding year.

137. Gradual implementation of a common market may take different forms. For example, one might liberalise trade commodity by commodity, say, first the products of one industry, then products of another industry, and so on. On the other hand it would be possible to have a gradual elimination of trade barriers for all or many products simultaneously. In that case the programme might or might not be divided according to the nature of the trade barriers : for example, one might first eliminate quantitative restrictions, then tariffs, then restore currency convertibility.

138. We do not consider it our task to recommend any particular method of trade liberalisation but would merely note that there is much to be said for reducing obstacles to trade in respect of many commodities simultaneously. Such a programme is less likely than a more restricted one to result in substantial unemployment in any particular industry.

139. The shifts in trade, production and employment to which such a programme would give rise would involve the expansion, in each individual country, of certain firms or industries producing for export, while certain firms or industries competing with imports would contract. Such shifts will probably be far easier to achieve if the former firms or industries are expanding at the same time as the latter are contracting. This would not happen if trade in one particular sector only were liberalised ; in that case some countries would on the whole experience an increase in production in that industry while other countries would be struggling with problems of redundancy in the same industry. These problems would ultimately be solved as and when trade in the products of other industries was also liberalised, but the problems of transition would

on the whole tend to be more awkward than if liberalisation were undertaken on a broader front. Furthermore, a simultaneous reduction of trade barriers in respect of all or the large majority of goods would permit of a gradual and smooth adjustment in the relative price levels of the participating countries through the various methods mentioned earlier in this chapter. Under a sector approach, if one sector of trade were liberalised after another, this important aid in easing problems of transition would be far less effective.

140. If more or less complicated rules concerning escape clauses or "peril point" provisions were accepted, under which certain countries or certain industries could apply for exceptional treatment (for example, initiation of the liberalisation process at a later date or the spreading of successive steps of liberalisation over a longer period), there would be risks of endless negotiations on a very large number of allegedly special cases. This would seriously endanger the whole programme of liberalisation. It may be found necessary, in certain cases where liberalisation, however gradual, would cause severe disturbances in production or employment, to make available some special assistance. We believe, however, that such assistance should be given in the form of technical aid or financial compensation rather than by way of allowing difficult cases to remain outside the general programme for trade liberalisation. [1]

141. The need for special measures on behalf of difficult cases would be reduced considerably if the transition period were made sufficiently long. For this purpose, even though in conditions of full employment the possibilities of transferring workers from one job, firm, or industry to another ought to be substantial, the transition period would, we believe, have to be of the order of at least ten years.

142. In this way the impact of trade liberalisation (that is, the shifts in trade, production and employment caused by the reduction of trade barriers) would be spread over a substantial period during which the necessary adjustments could take place gradually. [2] One

[1] As we have said in Chapter II, however, the special treatment which we believe should be accorded to the underdeveloped areas of southern Europe may have to include greater freedom to maintain protection than could be accorded in other cases.

[2] The question whether the process of adjustment could be further eased by measures of international harmonisation in the field of social policy is considered below.

method of smoothing out the process of adjustment over the period of transition as a whole might be by making periodic (for example, annual) reductions in existing tariffs by equal percentages of the residual tariffs prevailing at the beginning of the year in question, until the tariff had been brought down to a very low level, when it could probably be abolished in one move without great difficulty.[1]

143. It will be clear that, if the transition period is to serve its full purpose, steps should be taken to abolish gradually such import quotas as have not yet been abolished under the O.E.E.C. liberalisation programme.

Special Assistance for Difficult Cases

144. We believe that if trade barriers were removed gradually and if appropriate economic and social policies were adopted, no major social or economic problems would be created by the establishment of a common European market. If the period of transition were sufficiently long, widespread transitional unemployment would be unlikely to occur. Still, local problems might arise which would be serious enough to justify special measures for assistance to the workers affected by a sudden increase in foreign competition.

145. We do not think that every step in the liberalisation process would give rise to this sort of problem. For example, if a high tariff is somewhat reduced, the immediate effect may very well be that profits of some firms are somewhat reduced but that output and employment remain fairly constant. It is unlikely that wages will be adversely affected by trade liberalisation. As the wider market will from the beginning tend to bring about a more efficient use of resources, it is reasonable to assume that, if serious difficulties are avoided, the national product in every country will rise somewhat more than it would otherwise have done. Under such conditions real wages will tend to rise. If, in some countries, the cost of living were to fall considerably, a rise in real wages would come about even if money wages remained stable. In any case there would be no advantage in attempting to prolong the life of certain lines of production by reducing wages. In some cases reduction in protection may lead to a contraction of output and employment as well as profits in high-cost firms. In many cases,

[1] See Appendix III.

however, it should be possible to some extent to adjust domestic costs to the lower prices by improving methods of production.

146. But it is nevertheless possible that at some stage of the transition period a particular industry may be especially hard hit. This might happen, for example, when the tariff on a particular commodity falls to a level where it becomes difficult for the majority of domestic producers (those who are neither particularly inefficient nor particularly efficient) to continue production at competitive prices.

147. We have already indicated that we think such problems should be solved by appropriate positive action rather than by delaying the process of trade liberalisation. If, for example, it were decided to prolong the transitional period in such cases, this period would probably never come to an end. Many other industries would probably be able to give persuasive reasons why they should also qualify for special treatment in the field of tariff reduction. We consider it preferable that the social problems involved in such cases should be met by means of special assistance rendered by the community to those who are particularly affected by the liberalisation process. At the international level this principle has been applied within the framework of the European Coal and Steel Community under the Convention concerning transitional measures *(Convention relative aux dispositions transitoires)*. If, as a result of the establishment of the common market, certain enterprises or parts of undertakings have to cease or to change the nature of their activities, the High Authority may, in co-operation with the government of the country concerned, grant non-reimbursable assistance for the benefit of the workers affected. This assistance may be used to contribute to—

(a) the payment of indemnities to tide the workers over until they can obtain new employment ;

(b) the granting of allowances to the workers for reinstallation expenses ; and

(c) the financing of technical retraining for workers who are led to change their employment. [1]

The government of the country concerned must itself make a special contribution of at least the same amount unless the Council

[1] Article 56 of the Treaty establishing a European Coal and Steel Community; and section 23 of the Convention concerning transitional measures.

of Ministers decides otherwise. The High Authority may in certain cases also participate in the financing of programmes for the creation, either in the industries which come within its competence or even in any other industry, of new and economically viable activities which would ensure productive employment to workers released by the introduction of new production techniques in the coal and steel industries.

148. Under these provisions the High Authority has, for example, made available a sum of 500 million French francs for the transfer, over a period of three years, of about 5,000 miners who might be willing to move from the Centre Midi coal basin to Lorraine, so as to cover costs of moving, transport and reinstallation. The actual results of this programme have, however, been very limited : between April 1954 when the project was started and the middle of 1955 not more than 250 workers had actually moved to Lorraine. The causes of this comparatively small achievement include housing shortages and similar difficulties, but also a clear unwillingness on the part of the workers concerned to migrate to another area even when their employment is threatened.

149. The High Authority has also made available funds for the re-employment of workers in the Italian iron and steel industry by the initiation of new and the expansion of existing activities in a number of industries. Other projects of this nature include assistance for the re-employment of 2,000 Italian coal miners and of about 1,500 workers in the French iron and steel industry. A different type of assistance consists in the levying of a special temporary equalisation charge payable by German and Netherlands coal mines for the purpose of facilitating sales of Belgian and Italian coal which is produced at higher costs than correspond to the coal price in the common market. Under this scheme the German mines had, up to the middle of 1955, contributed the equivalent of $31.3 million, while the Netherlands mines had paid a total sum of $2.7 million.

150. We have a great deal of sympathy for the philosophy underlying international measures of this nature, under which those who benefit from the establishment of a common market render temporary financial assistance to the countries who benefit less, so as to help them in solving the social problems arising out of the common market. Such measures are particularly useful if the common market is to be established within a short time, as in the

case of the European Coal and Steel Community. They are also relatively easy to administer when a common market is established for a few products only and when the operation of the common marked is entrusted to a supra-national agency such as the High Authority, which has the power, for example, to levy charges on the industries concerned and to use the proceeds of these charges with a certain measure of freedom.

151. We have noted that the actual results achieved through the readjustment mechanism of the Coal and Steel Community seem to have been more limited than might perhaps have been expected. This may have been due at least in part to the fact that favourable conditions have prevailed in the coal and steel industries in the countries concerned. Under these conditions governments may not have felt it necessary to make much use of the readjustment mechanism. We understand, however, that various difficulties have been encountered in the application of these arrangements. There appears, for example, to be a certain hesitation among governments and enterprises to apply for assistance, for fear of interference by the High Authority in their internal affairs. Secondly, governments may have difficulty in raising the contributions which they are required to make themselves when receiving financial assistance from the High Authority. Thirdly, governments may hesitate to apply for assistance and to contribute thereto themselves on behalf of particular industries, for fear that other industries might also (and with some justification) demand special assistance.

152. In the light of the above considerations we have examined the question whether an international readjustment fund with functions similar to those of the fund administered by the High Authority might be useful and practicable in connection with the type of international economic co-operation with which we have been concerned in the greater part of this report, namely a freer European market and the special case of the establishment of a customs union through a series of tariff reductions. It appeared to us that the administration of such a fund would raise difficulties no less great than those which have been encountered by the High Authority. Indeed, the difficulties might even be greater. Under a system of gradual tariff elimination simultaneously in respect of all internationally treated goods, a whole range of industries would be affected at the same time. In each country there would be some industries experiencing difficulties due to increasing competition,

but at the same time, in each country, some industries would be expanding. While in the case of the Coal and Steel Community the net effects of the establishment of the common market in each participating country may be assessed with a reasonable degree of clarity, it would be far more difficult to do so in the case of a general common market. Accordingly, it would probably be extremely difficult, if not impossible, to determine which countries and which industries would have to make contributions to the fund, how large these contributions should be and, conversely, which industries in which countries would be entitled to assistance from the fund.

153. Nevertheless, an effort would have to be made to overcome these difficulties (which would be the more intractable because they would require international agreement on the very thorny questions indicated above) if the establishment of an international readjustment fund were considered indispensable as a means of overcoming the social problems involved in shifts in the pattern of trade, production and employment. We are not convinced that such a fund would be very necessary in the case of countries which have already reached an advanced stage of industrialisation and economic development. If, in accordance with the suggestions made in the previous section and in contrast with the method followed in the establishment of a common market for coal and steel, it were decided to provide for a relatively long period of transition, it would seem likely that during this period in each participating country a contraction in some industries would, broadly speaking, be matched by an expansion in some other industries. It is therefore perhaps fair to say that there is no reason to expect that among the countries concerned there would be any which during the transition period would suffer so badly from the establishment of a common market that they would need substantial international assistance in overcoming problems of re-employment, retraining, movement of labour and unemployment benefits. On the whole, we would expect that the technical means and the funds necessary for that purpose could be found within the countries themselves.

154. The position is different in respect of countries which have not yet reached a stage of balanced economic development at which the large majority of the population is fully employed. These countries are faced with tremendous problems, including a serious shortage of capital. Their whole position as regards international economic co-operation differs substantially from that of the countries of northern and western Europe. Some of these special

problems were discussed in Chapter II, in which we concluded that there is a strong case for international co-operation in the field of investment with a view to solving, through a common effort, the problems of the underdeveloped areas of southern Europe; consideration might be given to the question whether such co-operation might usefully include the establishment of an international fund to assist in the training, retraining and transfer of workers in these areas.

HARMONISATION OF SOCIAL CONDITIONS DURING THE TRANSITION PERIOD

155. There is, as we have said, a widespread feeling that freer trade in Europe should not be allowed to put industries of particular countries at an artificial competitive disadvantage compared with similar industries in other countries as a result of differences in labour standards. This feeling has given rise to the view that it may be necessary to reduce international differences in certain social conditions as determined by legislation and collective bargaining through some process of international "harmonisation" in this field. If such "harmonisation" should in fact prove necessary, it would probably be best undertaken during the period in which trade barriers themselves are being reduced. The transition period would then serve the dual purpose of gradually establishing a freer market for commodities and creating the conditions in which competition in such a market could effectively bring about a rational pattern of international specialisation and trade.

156. It may be recalled that in our analysis in the preceding chapters we have already touched upon certain considerations which are relevant to the problem of harmonisation. In particular, we have argued in Chapter III that, contrary to what is sometimes believed, it is neither necessary nor practicable to eliminate or to reduce substantially international differences in the general level of labour cost per unit of time (for example wages plus social charges per man-hour or per man-week). We have also argued that there is in principle a case for measures of harmonisation when in any country wages and social charges paid by employers in one industry are exceptionally low in comparison with the general level of wages and social charges in the same country. Thirdly, when discussing in Chapter II the impact of general government social policies on international trade, we concluded that, although such

policies do affect the composition of production and foreign trade of the country concerned, international differences in such policies do not as a rule reduce the advantages which these countries derive from freer trade and therefore do not normally constitute an economic ground for harmonisation.

157. On the basis of these considerations we proceed in the following paragraphs to examine in rather more detail the question to what extent it may be desirable to harmonise certain social conditions concomitantly with the gradual establishment of a freer market for commodities and in what ways such harmonisation might appropriately be undertaken.

Possible Measures of Harmonisation in the Field of Wages

158. While the statistical material which was at our disposal did not show that there are substantial inter-industrial differences in wages in European countries, we would agree that wages which are exceptionally low compared with wages paid in other industries (or regions) of a particular country may have a distorting effect on international competition and may therefore call for corrective action. When applying this principle it should, however, be remembered that international differences in wages and other labour conditions depend upon a complicated set of factors, including differences in national traditions and customs, differences in the strength of trade unions, the nature of the different jobs, the demand for and availability of particular skills, and so on. Wages and labour conditions are moreover, in European countries, usually the outcome of collective bargaining, and there is widespread agreement that government interference with the freedom of collective bargaining, if it becomes necessary at all, should be kept to a minimum. Moreover, inter-industrial differentials in wages and other labour conditions perform certain functions. For example, they serve to remunerate various groups of workers for their particular skills or efforts and they are, or at least may be, instrumental in securing an efficient distribution of the labour force among different industries by attracting workers to more productive and drawing them away from less productive industries. An attempt to establish identical patterns of relative wage rates and labour conditions in different industries in each of a number of countries would certainly represent an unduly rigid approach.

159. Furthermore, it should be borne in mind that minor

differences between countries in the relation between wages and social charges in different industries do not appreciably affect the pattern of international trade and competition. If differences in inter-industrial patterns of wages do not correspond exactly to differences in skill, etc., profits in some industries in some countries may perhaps be a little lower or higher than they would otherwise have been, but such divergencies in wage patterns do not decide the fate of the whole industries. This is determined mainly by basic differences in material resources, the skill of labour and the efficiency of entrepreneurship and management; compared with these factors small differences in wages, resulting, for example, from differences in the bargaining strength of trade unions in different industries, are not really significant. Whatever may be the nature and scope of a policy aiming at the abolition of differences in labour cost per unit of time beyond those justified by differences in skill, etc., such a policy need not attempt to go beyond the elimination of such discrepancies within each country as would substantially distort the international division of labour by causing certain lines of production to be carried on in areas and by methods which are clearly less suitable than other areas or methods would have been but for the existence of distorting features in the wage structure. It would seem to be consistent with the interests of the trade union movement to promote and support action to put an end to unjustified differences in labour costs for the benefit of low wage groups.

160. In this connection we wish to draw attention to provisions such as those which appear in Article 2 of the draft European Social Charter drawn up by the Council of Europe in 1955. Under this article governments would undertake to encourage the adoption of measures which would ensure progressively for everyone, *inter alia*, "a wage... which provides equal pay for equal work (and) ensures for himself and his family a decent existence, guaranteed more particularly by the introduction of a minimum wage, the fixing of wages in relation to this minimum (and) the periodical adjustment of the wage by reference to the cost of living and the economic situation". If countries agreed to implement certain of these principles, consideration might be given to the adoption of an international labour Convention designed to be applied on a regional basis in Europe. We also want to mention the existing I.L.O. Minimum Wage-Fixing Machinery Conventions for manufacture and commerce and for agriculture, although these Conventions in their

present form would probably not be considered adequate for the purpose of eliminating distortions in any country's wage structure.

161. The drafting of an international Convention of the type we have indicated above would raise a number of technical problems which we cannot discuss here ; they might, perhaps, be best considered in the first instance by a future I.L.O. European Regional Conference or by an I.L.O. tripartite conference of the countries directly concerned.

162. Again, it may be argued that a certain distortion of international competition arises from differences in the extent to which the principle of equal pay for men and women is applied in different countries. Countries in which there are large sex differentials will pay relatively low wages in industries employing a large proportion of female labour, and these industries will enjoy what might be considered a special advantage over their competitors abroad where differentials according to sex are smaller or non-existent. A policy of gradual reduction of these differentials would tend to prevent this. It may be recalled in this connection that the I.L.O. Equality of Remuneration Convention, 1951 has been ratified by Austria, Belgium and France but not, as yet, by other Western European countries. Many circumstances may make it difficult to apply the principle of equal pay. To mention one example : there are areas in which heavy industries mainly requiring male workers are concentrated. In such areas employment opportunities for female workers at wage rates customary for male workers in comparable jobs may be very restricted compared with the number of women who would like to take up employment for wages, whereas, if the wage rate for female workers were put somewhat lower, light industries which could employ a large number of female workers might be attracted to the area in question. There are probably many other situations in which full application of the principle of equal pay raises practical difficulties. It would therefore seem useful to undertake an inquiry into the nature and seriousness of the circumstances which have prevented the Convention from receiving wider ratification in Europe. On the basis of such an inquiry consideration might be given to the ways in which more rapid progress might be made toward the objectives of the Convention, having regard to the specific conditions prevailing in European countries.

Differences in Methods of Financing Social Security and Welfare Schemes

163. Another aspect of social policy which has attracted attention in connection with international competition concerns differences in national methods of financing social security and welfare schemes. It has been observed that some countries finance social programmes largely out of general tax revenue, a substantial proportion of which is derived from taxes on personal and corporate incomes. Other countries finance such programmes largely out of levies on industry which are more or less proportional to the payroll of each establishment.

164. This is one of the reasons why "social charges" (in the sense of specific levies payable by employers for the purpose of financing specific benefits accruing to wage earners or other social groups) vary between different countries.[1] In cases where a large proportion of social security and welfare programmes is financed from general tax proceeds, social charges can be lower than in cases where such programmes are financed to a large extent by payroll taxes, even though the level of social security and welfare benefits per head may be roughly the same. Many producers who are subject to, for example, payroll taxes which directly enter into their cost of production believe that this particular method of financing social services puts them at a competitive disadvantage compared with producers in countries where similar programmes are financed in a different fashion.

165. The economic and social problems resulting from differences in methods of financing social programmes are extremely complicated and they cannot be fully analysed here. They include questions of redistribution of income, of changes in the level and composition of consumption, savings and investment, and problems of international trade and competition. What makes the analysis of these questions particularly complicated, and the ultimate effects of particular methods of financing almost untraceable, is the phenomenon of shifting of the incidence of taxation mentioned in an earlier part of this report. A brief analysis of probable long-term effects of different types of taxation as affected by shifts in incidence is presented in Appendix II to this report.

[1] See table I on p. 33 and table E in Appendix I.

166. A first observation which may be made in the light of that analysis is that the pattern of production in the various countries, and hence the composition of international trade among them, whether there is a common market or not, will be different from what it would have been if there had been no social security and welfare schemes and no systems for financing them. Secondly, the effects of these schemes and systems on the structure of production and international trade would probably have been different from what they actually are if methods of finance other than those actually adopted had been chosen. As indicated in Appendix II, the nature and size of shifts in the incidence of taxation vary with, among other things, the types of taxation, and are determined by elasticity of supply and demand and certain other factors. As a result, in each country certain industries will be larger and others will be smaller than they would have been if there had been no system, or different systems, of social security and other types or levels of taxation. Thirdly, if certain countries had chosen other systems of taxation than those they actually selected, they might have developed a more productive or otherwise superior economic structure than they actually have. These are extremely interesting and important questions and it is surprising that rather little scientific research has been undertaken into the effects of different types of taxation on international trade.

167. In the present context we are interested in a more restricted problem, namely whether the existence of differences in the systems of taxation imposed for the purpose of financing general social programmes [1] in the participating countries constitutes an obstacle to the establishment of an effective common market and whether, therefore, some degree of harmonisation in this field is a necessary concomitant of the liberalisation of trade. The answer will depend on whether, as a result of the existence of different systems of taxation, the abolition of trade barriers would distort the structure of production in any country in the sense that certain industries would be forced to contract or to disappear altogether, while less productive industries in the same country would expand.[2]

[1] Programmes which are uniform for all industries in the country concerned. The case of social programmes applied in particular industries only is considered below.

[2] We do not consider it realistic to assume that the distortion would ever involve lasting unemployment of resources. We are only concerned with the efficiency of the pattern of production and trade.

168. It follows from our analysis in the preceding parts of this chapter that this could happen only if *(a)* the burden which a certain system of taxation imposed on one industry in any country were heavier than the burden which the same system of taxation imposed on other industries in the same country, and *(b)* in another country where a different system of taxation was applied the distribution of the burdens of that system among individual industries were different from what it was in the former country ; this might be the case, for example, if the system of taxation in the second country weighed equally heavily on all industries in that country, or if the industry on which a relatively heavy burden was imposed in the former country bore only a relatively small burden in the second country.

169. In speaking of the "burden" of a tax we mean, of course, its ultimate incidence on cost of production. As we have observed in Chapter III above, the burden of any tax may be shifted in whole or in part away from the person or group on whom the tax is originally levied to other persons or groups. The scope and nature of this shifting process differs with the nature of the tax, with the elasticity of demand and supply for the products concerned and, in so far as the shifting to workers of a tax on employers is concerned, with the relative strength of trade unions and employers' organisations. Therefore the actual burden of a system of taxation which in form appears to weigh equally heavily on all industries may in fact be different as between different industries within the same country. Also, even if two countries apply exactly the same system of taxation but if, as will often be the case, the factors determining the scope and nature of the shifting process are different, the distribution of the ultimate incidence of the tax between different industries may be different in the two countries. Finally, since it is well-nigh impossible, at least in many cases, to determine precisely to what extent the tax is actually shifted, it is practically impossible in the case of taxes such as a general tax on incomes or a general payroll tax, to say whether the tax does impose unequal burdens on different industries, and if so to measure the extent of this inequality.

170. There seems to be a strong presumption that a general payroll tax, which has the same influence on labour costs as wages, is to a considerable extent shifted on to wage earners. Wages in countries with such taxes will have risen less than they would otherwise have done, as producers would have been able to pay

higher wages if their labour costs had not been raised by the payroll tax. The process of shifting the incidence of taxes on personal and corporate incomes is probably more involved but it is generally believed that such taxes are also shifted, at least in part.

171. It should, moreover, be borne in mind that taxes levied for the purpose of financing programmes of social security and welfare are not the only general measures of economic policy which affect the structure of production and employment. All countries have other taxes and regulations, a rate structure for rail transport and other features which in one way or another have an incidence on the competitive position of different industries and even of different factories within the same industry, and this incidence differs as between various industries and enterprises. One should therefore be cautious in judging whether a particular method of taxation for the purpose of financing social security and welfare schemes does or does not involve a "distortion" in the structure of production in the country concerned. Assuming for the moment that it is possible to establish that the burden of, say a uniformly applied payroll tax falls more heavily on one industry than on other industries in the same country, it may be that the effects of the tax add to the effects which result from other economic policies such as the general system of taxation or the system of transport rates. But it may also be that the effects of the former serve to offset wholly or in part the effects of other elements of economic policy. There is even ground for the presumption that in the real world such compensating effects will be found more often than the accumulation of effects that operate all in the same direction.

172. Bearing all this in mind it seems highly doubtful whether it would be desirable to proceed to harmonisation in one particular field of economic policy such as the financing of social security schemes without proceeding at the same time to the harmonisation of other policies, the economic effects of which may be similar ; and it is not at all certain that even a measure of harmonisation extending over a wide range of economic and social policy would in fact bring about a less distorted structure of production and trade.

173. As regards the specific question whether international harmonisation may be called for in respect of systems of financing social security and welfare schemes, we conclude that such harmonisation should be attempted only if *(a)* in spite of the great difficulties involved in any estimate of this kind it is clear that the systems in

operation in one or more countries involve substantial inequalities in the burdens imposed on various industries within the same countries without being compensated by the effects of other regulations and policies in the same countries, and *(b)* the effects of these inequalities on the pattern of production and trade are substantial. In any case the need for harmonisation in this field is not, in our judgment, a prerequisite to the establishment of a freer market. Such harmonisation as may be found possible and desirable could be undertaken in the course of the transition period.

174. But in addition to general social programmes there are certain special programmes which provide, for workers in particular industries such as coal mining, benefits which are higher than those received by workers in other industries and are considered justified as compensation for special hardships or risks in the industries in question. The higher social benefits which coal miners receive, by way of compensation for the greater-than-average risks to health and safety to which they are exposed, are financed out of general revenue to a greater extent in some countries than in others. In countries in which a substantial contribution is made from general revenue to the cost of special social programmes in particular industries, it may be argued that these industries are receiving a form of subsidy which gives them a competitive advantage over the same industries in other countries. If some countries finance special social programmes for workers in particular industries by methods which cause the burden to fall largely on consumers of the products of those industries, and if other countries do not, there is a case for action by the latter to bring their methods of financing such special social programmes more closely into line with the methods adopted in the former. For it seems right and proper that as a general rule those who wish to consume goods whose production has involved special risks or hardships should be charged a price which will cover fair compensation for these risks or hardships.

175. More generally, if there are cases which clearly involve substantial distorting effects on the pattern of production and which can be unambiguously identified as involving subsidies or burdens affecting particular commodities or industries only, either there may be justification for a measure of international harmonisation or, if no agreement to that effect can be reached, countries in which particular industries are found to suffer might be permitted to reimburse the taxes in question when their goods are exported.

Harmonisation in Other Fields of Social Policy

176. Differences in hours of work and in provisions regarding payment for overtime may also give rise to differences between countries in the inter-industry pattern of labour costs. If these cost differences could be expressed per unit of product and not per unit of time, their significance would probably be less than might at first appear, because, where hours normally worked [1] are relatively short, output per hour may tend to be relatively high and because, as we have already observed, overtime work permits a spreading of overhead costs.

177. Basically the normal length of the working week in any country or industry seems to us a matter which should be determined by the country itself (in the light of people's preferences in respect of higher material income and leisure). Within each country collective bargaining in particular industries will often be the most generally acceptable method of determining the normal length of the working week.

178. Commenting on the economic significance of international differences in working hours and overtime premium rates, we observed in Chapter II that if working hours and overtime rates differ from one country to another this probably reflects differences in people's inclination to work long hours or to work overtime. Such differences in the size and elasticity of the supply of labour have an impact on patterns of production and international trade, but these effects are not of a nature which can be said to be "distorting". If at any given time people in different countries feel differently about normal working hours and overtime they will benefit from freer trade on the basis of differences in comparative cost as determined, *inter alia*, by their attitudes to working hours just as well as if there had been no such differences in attitude. There is therefore no economic reason for harmonisation in this field.

179. Attention may be drawn to the existence in this field of an element which is analogous to the phenomenon, mentioned above,

[1] In some countries, France for example, these include a certain amount of time that is normally designated as "overtime" and is paid accordingly. The result is that average hours actually worked are normally somewhat higher than would appear from collective agreements and average total earnings are higher than would appear from statistics of ordinary hourly wage rates and earnings.

of the interdependence of various factors affecting the choice of methods of financing social security and welfare schemes. We suggested there that the effects of taxation may serve to offset wholly or in part the effects of other elements of economic policy. In the field of working hours there exists a similar interdependence between normal wage rates, working hours and overtime premium rates. Under collective bargaining in a particular industry these three elements are determined simultaneously on the basis, among other things, of workers' preferences in respect of normal hours, shift work, total weekly earnings, etc., on the one hand, and on the other, employers' estimates of the cost involved in various possible lengths of the working week, the possibilities of shift work, their preference as between longer hours and a larger staff, and so on. The bargaining process gives both parties an opportunity to consider various possibilities ; for example, a concession by the employers as regards normal hourly rates and overtime premium rates may be considered in exchange for concessions by the workers in respect of the normal length of the working week and the conditions in which and the rates at which recourse may be had to overtime. As a result wage rates, normal and overtime, and working hours in any industry constitute a finely balanced complex of interdependent elements. For this reason it seems highly doubtful whether it would be desirable or feasible to proceed to harmonisation in respect of one particular element, such as working hours, without considering at the same time both normal hourly rates and overtime premium rates in particular industries, and again it is not at all certain that harmonisation of all these elements simultaneously would in fact correct any distortion in the structure of production and trade.

180. However, it may be that in a particular country working hours are very much longer in one industry than in others—for example because workers are very weakly organised in that industry. As a result the industry in question may have a significant advantage compared with competitors in other industries where working hours are at the level that is customary in the country concerned. It is doubtful whether many instances of this nature exist but in certain cases the fixing of minimum standards in respect of normal hours of work, the conditions under which overtime is permitted and the payment of overtime, by preventing the standards applied in these matters in particular industries from falling below an internationally accepted level, might eliminate abnormal competition

and thus facilitate the establishment and preservation of a régime of freer international trade. To this end, consideration might be given to the possibility of general acceptance by European countries of such standards as are laid down in the I.L.O. Hours of Work (Industry) Convention, 1919, in certain other I.L.O. Conventions relating to hours of work, or perhaps in a new instrument or instruments which might be established through the machinery of the I.L.O. with a view especially to application in Europe.[1] Any standards laid down in such instruments should, however, be defined in a way which would leave latitude to each country to implement them with reasonable regard to national and local conditions.

181. Standards laid down in I.L.O. Conventions relating to such matters as labour inspection services and industrial hygiene and safety, if applied throughout a group of countries, might similarly serve to prevent standards in particular industries from falling below accepted national levels and thus giving rise to abnormal competition. We do not, however, consider ourselves competent to examine the provisions of international labour Conventions in detail with a view to determining whether the standards they lay down are suitable from the point of view of preventing labour conditions in particular industries from falling below acceptable national levels, and whether these standards could with advantage be modified or supplemented by new standards embodied in new or revised instruments designed especially for application on a regional basis in Europe. The Governing Body may wish to consider whether an examination from this point of view of a selected list of international labour Conventions is a task which could usefully be undertaken at a future I.L.O. European Regional Conference or at an I.L.O. tripartite meeting of the countries directly concerned.

182. Summing up our analysis of the possible need for harmonisation of social conditions and policy, we conclude that the extent to which such harmonisation may be required for the effective operation of wider markets seems to be smaller than is often thought. Differences in the general level of labour costs do not give rise to special difficulties from the point of view of international com-

[1] The Hours of Work (Industry) Convention, 1919, has been ratified by Austria (conditionally), Belgium, France (conditionally), Greece, Italy (conditionally), Luxembourg, Portugal and Spain. Other I.L.O. Conventions relating to hours of work have obtained few ratifications.

petition, since countries with high labour costs per hour possess advantages which compensate for these high costs.[1] Differences in the inter-industrial pattern of labour costs might, however, give rise to certain difficulties and, while we have not found practical examples in which substantial distortions in the pattern of international trade and competition are likely to be caused by such differences, it is possible that cases may occur in which it will be desirable to reduce such disparities. Such measures for harmonisation as may be called for should not be regarded as a prerequisite to the liberalisation of trade but should be undertaken during the period of transition. In this connection we have noted that the implementation of the Benelux economic union has necessitated a surprisingly small degree of harmonisation in the field of social and other policies.

183. In those cases where a measure of harmonisation may be found to be necessary, certain countries may for various reasons find it difficult to adjust their social conditions and policies in such a way as to reduce distortions in the pattern of international trade and competition. Should marked differences in the inter-industrial pattern of labour costs persist even after the transition period is over, consideration might be given to allowing a country to refuse admission to its markets, on terms as favourable as those governing the admission of other goods, of commodities produced by an industry in another country in which labour conditions are markedly "substandard" in relation to labour conditions in other industries in the exporting country. We wish to repeat, however, that we have not found practical examples in which such a situation is likely to arise.

The Role of Freer International Movement of Labour and Capital

184. Several European countries exert a more or less rigorous control over international movements of capital and especially over the immigration of labour. Some of the broader considerations which would be involved in any liberalisation of the international movement of labour and capital were mentioned in Chapter II and

[1] The fact that labour costs may be "too high" in one country and "too low" in another in relation to a well balanced position has been discussed above. Such maladjustments have to be corrected whether trade is liberalised or not.

we shall return to the subject in Chapter VI below. In the following paragraphs we comment briefly on the contributions which migration and capital movement on a limited scale might be expected to make to the mitigation of problems of transition to a freer international market for commodities.

Freer Movement of Manpower

185. If the process of trade liberalisation were spread over a sufficiently long period of transition, such shifts as would be called for in patterns of production and employment within the participating countries could be brought about without causing any substantial fall in the level of employment or any substantial labour shortage in any of the countries concerned. Indeed, the very purpose of our recommendation for *gradual* reduction in trade barriers is to lessen appreciably the risk of serious transitional unemployment, and we should consider any arrangements for trade liberalisation which would cause unemployment on any considerable scale as of doubtful value. Secondly, as far as the longer-term aspect of the matter is concerned, we believe that in a régime of freer international trade, provided that such complementary measures are taken as we have advocated in Chapter II, countries which now have less than full employment should be able to use more, not less, of their labour resources and to use them more effectively. We therefore wish to emphasise that for a trade liberalisation programme to benefit the participating countries it is not necessary to have freer movement of labour. Even if there were no relaxation of restrictions on the movement of labour, most countries would gain from the advantages of accelerated economic growth and greater specialisation that would flow from freer trade.

186. But, while freer movement of labour is not a prerequisite for the establishment of a common market for commodities, some of the transitional problems that might arise from trade liberalisation would be easier to solve if there were somewhat freer international migration of manpower. Since a common market would bring about shifts in trade, production and employment, it might be helpful in certain cases if workers in contracting industries were permitted to take up employment in their own occupations in other countries where the same industries are expanding. If this principle were widely applied substantial numbers of wcrkers would bring their traditional skills to the expanding industries and would

facilitate this expansion while at the same time reducing the impact of the contraction of these industries in their own countries. We consider that freer international movement of labour for this purpose would be desirable and that participating countries should take measures to ensure that this type of migration is not unnecessarily hampered.

Capital Movements and the Transition Period

187. We have already commented briefly on the idea that countries might render each other financial assistance in order to mitigate the losses of capital and employment which may result from shifts in production and employment following a substantial reduction in obstacles to trade. We have expressed the view that in arranging for closer economic co-operation European countries, instead of developing complicated systems of mutual financial assistance to overcome problems of transition, should seek to avoid a situation in which there would be any great need for such assistance, at least among the more highly developed countries. If a sufficiently long period were allowed for the establishment of a freer market for all or most commodities, the local difficulties of transition would be limited to dimensions which could normally be managed by the governments of the various countries without recourse to special international funds. Should it be considered desirable, for one reason or another, to achieve a complete or virtually complete elimination of trade barriers more quickly than we have contemplated, the problems of transition would be more difficult, and the case for special international financing to support countries which were particularly hard hit might then be stronger. From an economic point of view there are, of course, limits to the speed with which a common market could be established. Any attempt to institute it over a period much shorter than the one we have suggested would seem unlikely to accelerate the increase in output and income of the participating countries : if anything it would be more likely to slow down the rate of growth of production in the co-operating countries taken as a whole, precisely because of the losses in capital and skill for the compensation of which a fund for international assistance might seem desirable. On the other hand, there are political and psychological reasons which may make it desirable to achieve important results in the liberalisation of trade as quickly as is economically possible, even if such speedy action should give rise to temporary difficulties in certain countries. In

such circumstances the other participating countries might reasonably be expected to provide some financial assistance toward the alleviation of these difficulties.

188. International movements of private capital might greatly facilitate such shifts in the pattern of investment as liberalisation of trade might call for. To the extent that freer trade leads to a contraction of certain industries and a simultaneous expansion of other industries, capital investment in the former will shrink as equipment depreciates and new capital will need to be channelled into the expanding industries. Theoretically this process could take place through the intermediary of the capital market. In actual practice, however, investable funds which are created in industry itself through profits or the accumulation of reserves for depreciation do not normally seek reinvestment through the capital market. They are as a rule ploughed back into the industry itself, normally in the firm from which they came [1] but sometimes in related firms or subsidiaries producing the same or similar products in another country. Investments of this type involving international capital movements are facilitated by the existence of close financial connections between the various branches of international concerns and between different firms as, for example, in the artificial textile and chemical industries of Europe. The establishment of a common market may be expected to lead to a strengthening and expansion of these international intra-industry financial relationships. It is thus quite possible that there may be a substantial increase in direct international investment if and when the elimination of trade barriers causes shifts in the pattern of trade, production and employment. Firms in countries where the prospects for expansion of output of their products will be less favourable under a common market may be disposed to invest some of their capital abroad in lines of production with which they are familiar, though they may hesitate to invest in expanding industries in their own country of which they have little knowledge. We believe that this type of direct investment in expanding foreign industries might be an important aid in mitigating problems of transition.

[1] For example, in France, in 1953, 34.6 per cent. of investments were self-financed, 12.6 per cent. were provided through the capital market, 13.6 per cent. through the banks and 39.2 per cent. through public finance (Commissariat général au Plan : *Rapport annuel sur l'exécution du plan de modernisation et d'équipement de l'Union française* (Paris, 1954), p. 23).

The Agricultural Problem

189. We conclude this chapter with a few brief observations on the transitional problems of agriculture. It is generally believed—and the global figures given in table 5 of Appendix III confirm—that liberalisation of trade in this sector would lead to very large shifts in production and trade. This is not surprising. On the one hand, natural differences in comparative advantage in the production of agricultural commodities are larger than in the industrial sector, because they are dependent to such a large extent on climatic and geographic conditions. On the other hand, government policies counteracting specialisation on the basis of comparative costs have been far more extensive in agriculture than in almost any other industry. Partly as a result of this, "in spite of the growth of population in Europe, the improvement of standards of living in much of the area and the further development of international transportation facilities, especially for perishable foods, the volume of foreign trade of European countries in agricultural products is now substantially smaller than it was 25 years ago".[1] This applies to trade among European countries as well as to trade between Europe and other areas.

190. There are a number of reasons for the large degree of government intervention in agricultural production and the resulting restrictions on international trade in this sector. First, excessive dependence on imported foodstuffs would be dangerous in the event of war. Secondly, in most countries the number of persons engaged in agriculture is relatively large and their total income is a significant fraction of the national income. Thirdly, because of the special conditions of production and consumption of agricultural products, agricultural prices and incomes are more liable to sharp fluctuations than those in other industries ; these factors, together with the fact that in several countries farmers are very effectively organised, explain why governments have considered it an important element of their social policy to come to the assistance of agricultural producers in order to stabilise prices and agricultural incomes. This factor was, of course, particularly important during the 1930s, when a world-wide agricultural crisis coincided

[1] United Nations Economic Commission for Europe and Food and Agriculture Organisation : *European Agriculture: A Statement of Problems* (Geneva, 1954), p. 66.

with a tendency for agricultural productivity in overseas areas to rise much faster than in Europe and agriculture became the most depressed industry in Europe. At the same time the possibilities of transferring labour from rural to urban employment (which are limited in the short run even in the best of times) were particularly limited because non-agricultural industries were also suffering from depression. In order to maintain farm incomes and employment above a minimum level, most governments had recourse to protective tariffs and import restrictions and applied more or less involved schemes of consumer and producer subsidies.

191. Before, during and immediately after the Second World War government intervention in agriculture was further extended in order to increase the degree of national self-sufficiency in the production of essential foodstuffs and raw materials. The reasons were, first, national security, secondly, the need to replace foreign supplies which were cut off when war had broken out, thirdly, the wish to alleviate balance of payments difficulties by reducing import requirements and, fourthly, the desire to keep the cost of living down during a generally inflationary period.

192. As a result of these and other factors the present agricultural situation in Europe is characterised by a number of special features. First, more or less elaborate and intricate systems of regulation and guarantees exist in almost every country ; these systems differ widely from country to country ; and they have usually been the result of successive emergency measures and therefore often lack consistency and co-ordination. "The protective devices employed are sometimes so intricate as to make it impossible even for governments to ascertain which products are really uncompetitive and which are only 'feather-bedded' by unnecessarily high support." [1] Secondly, since the emphasis in agricultural policies has been more on support to the farmers and on the need to foster production of particular commodities than on reducing cost of production, the level of productivity in many countries is rather low. Another factor contributing to the low level of productivity has been the relatively low level of agricultural money wages (see table B in Appendix I), as a result of which there has been little incentive to apply labour-saving techniques. Thirdly, many countries are now highly self-sufficient in respect of a number of products ; indeed, there is a tendency towards overproduction at

[1] *European Agriculture,* op. cit., p. 78.

present high prices, and the scope for expansion of production of these commodities is rather small. On the other hand, Western Europe is still importing a large proportion of foodstuffs from the Western Hemisphere, some of which are made available at prices below those prevailing in the exporting countries; these imports might to some extent be replaced by expanded European production. Fourthly, as a result of these various circumstances, the international pattern of production is probably far less efficient than it could be, and a liberalisation of international trade would lead to very substantial shifts in production and employment.

193. It is therefore perhaps not surprising that efforts to liberalise trade in agricultural products have encountered considerable difficulties. Initially the abolition of quantitative restrictions under the O.E.E.C. plan for removing such restrictions made less progress in respect of agricultural products than for other groups of commodities. Although the percentage of liberalisation in agricultural products is now of the order of 80, the O.E.E.C. scheme applies to non-government trade only, and in some European countries trade in agricultural products is to a large extent government-controlled. Furthermore, in many cases such restrictions as were lifted concerned trade in products subject to high import duties. Discussions on the establishment of a common European market for agricultural products by the European Conference on Organisation of Agricultural Markets (the so-called "Green Pool") between 1951 and 1954 have not led to practical results. At its second session the Conference decided to refer problems of a common market in agricultural products to the O.E.E.C.

194. The question arises whether the general approach to transitional policies which we have taken in this chapter should not be qualified in respect of the rather special conditions of agriculture. The question whether agriculture should be considered quite separately from the general problems of liberalisation of European trade is a controversial one. Some believe, for example, that a general economic organisation such as the O.E.E.C. is not technically competent to deal with the specific problems of a common European agricultural market. Others fear that a special international body for the integration of European agriculture of the type, for example, of the High Authority for coal and steel would be dominated either by producers' interests or by agricultural technicians who would take an unduly narrow view of the broad issues of international economic co-operation.

195. The answer may lie somewhere between these views. It can be conceded that agriculture is a special case mainly for two reasons. First, the difficulties of transition in this sector may differ considerably from those in other fields. Secondly, it would appear to us that the general objectives of international co-operation in agriculture must be wider than merely to increase productivity through better international division of labour as a result of freer international trade. As regards the first of these considerations, an important factor is that the size of the shifts in trade, production and employment which would result from the abolition of trade barriers may be much larger than in any other major industry. Secondly, it is important to note that the feasible rate of adjusting agricultural output and employment is limited by the rate at which employment opportunities outside agriculture can be created. While the rate of possible absorption of surplus agricultural labour is naturally larger in times of prosperity and full employment than during a depression, and while it is therefore considerably higher than before the last war, the necessary investments in capital equipment, urban housing, etc., for a large number of rural workers, over and above the normal rate of expansion due to the growing numbers and increasing productivity of the industrial population itself, may in some countries put a heavy strain on available resources. Both the size of the shifts between agricultural and non-agricultural employment and the feasible rate of absorbing agricultural surplus labour differ from country to country. Thirdly, problems of transition in respect of agriculture are complicated by the fact that a large proportion of rural workers are independent farmers rather than wage earners.

196. On the other hand, certain factors may tend to limit the probable seriousness of transitional problems in agriculture. First, there appears to be scope for a substantial increase in agricultural productivity so that it should be possible to maintain profitable agricultural production in a number of cases even when import restrictions and price support programmes are abandoned. An important cause of low productivity, particularly in the millions of small farms in many European countries, is lack of technical knowledge, which could be overcome by increasing public expenditure on education, research and extension services. Another cause of low productivity, especially of labour, in agriculture is the excessive fragmentation of holdings, which could be remedied by suitable policies for consolidation of unduly small holdings, parti-

cularly in the countries of northern Europe where the problem of a rural labour surplus is less serious than in the southern countries. Secondly, since agricultural production usually takes place under conditions of increasing cost, it is the marginal product which depends on subsidies and protection in order to be profitable, and it is the marginal output only which would disappear when subsidies and protection vanish. For example, while a fall in the price paid to farmers for wheat might result in the abandoning of wheat production on marginal, less productive land, a large volume of wheat production might still continue on more productive land.

197. Thirdly, agricultural production is flexible in so far as the same land, labour and capital equipment can, within limits, be shifted to the production of other commodities if the existing pattern of cultivation becomes unprofitable as the result of the disappearance of import restrictions, subsidies and the like. [1]

198. Fourthly, if some of the anomalies of the existing price pattern were removed, the consumption of a number of products could be substantially increased. It appears, for example, that high prices for animal products such as meat and for fruit and vegetables have kept the consumption of these products much lower in some high-income countries than it would have been if the consumer could have benefited from the lower prices which would have prevailed if the commodities in question had been produced in countries which have natural advantages for such production. While such an increase in demand might not benefit all countries it would facilitate the solution of transitional problems in at least some countries.

199. Finally, in the industrialised areas of northern and western Europe a spontaneous transfer of manpower away from agriculture towards industry has taken place during the post-war industrial boom so that the hired labour force in agriculture has been falling at the rate of some 3 to 4 per cent. a year, and even by as much as 6 to 8 per cent. in some countries during certain years. "In some countries, the withdrawal of young people from agriculture has been so rapid as to make it doubtful whether, within the

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[1] For this reason it would be desirable to extend plans for freer international trade in agricultural products to the full range of these commodities and not, as has sometimes been proposed, to limit their scope to a few selected products. Of course, the feasibility of shifts in production is relatively small in such cases as orchards, vineyards and specialised dairy farms.

next decade or so, enough will be left to take over all the farms now in existence. Statistical investigations demonstrate that this will be the situation in Denmark, and the same thing is happening in Sweden and can be expected to occur in some other countries as well." [1]

200. On balance it would appear to us that if the period of transition is made sufficiently long the problem of transferring such manpower as might become redundant in the agricultural sector of industrialised countries of Europe, as a result of the establishment of a freer market for agricultural as well as for other products, would be of a manageable size. While the position varies from country to country with differences in the relative size of the agricultural and industrial labour force, it has been observed that in most Western European countries, in order to provide sufficient employment outside agriculture to absorb the people set free by a reduction in the agricultural population by about one-third over ten years, an extra expansion on non-agricultural employment of only about 0.5 to 1 per cent. a year would be required. More serious difficulties may, however, arise if a country wants to maintain the incomes of the farming population at the same relative level compared with other incomes as at present, a goal which may be found essential in some countries at least.

201. A further important factor is the probability that trade liberalisation, a wider European market and the consequent rise in incomes will bring about an increase in the demand for agricultural products, particularly animal products, fruits and vegetables. This tendency is likely to be particularly important in the areas of surplus labour in the south. Here it is likely that liberalisation of trade in agricultural products would lead to a substantial increase in exports of fruits and vegetables for which these countries are particularly suited. At the same time the internal markets of these countries would expand rapidly if plans for industrialisation of these areas got under way. The present diets being as meagre as they are in these poor regions, an increase in income resulting from industrialisation would lead to a substantial increase in demand for foodstuffs which, if balance of payments difficulties were to be avoided, would need to be produced to a large extent within the countries themselves.

[1] *European Agriculture,* op. cit., p. 44.

202. We have already expressed the view that international co-operation in the field of agriculture should extend beyond the mere elimination of barriers to international trade ; and there is a widespread opinion that such co-operation would require the creation of special machinery. Proposals for liberalisation of international trade in agricultural commodities would probably not be acceptable to the majority of governments if provision were not made at the same time for ensuring a reasonable stability of prices and agricultural incomes and a measure of security of supply of the most important foodstuffs. These two objectives, which are important in ensuring general economic stability in the countries concerned, are also of evident social importance inasmuch as they are designed to protect both agricultural and industrial producers from the vagaries of an entirely unregulated market for commodities, the output and prices of which are subject to sharp short-term fluctuations. Thirdly, if agreement were reached on a substantial liberalisation of trade, it would be necessary gradually to abolish or harmonise such elements of domestic agricultural policies (subsidies, guarantees, quotas, tariffs) as obviously involve distortions in the pattern of production and international trade.

203. Acceptance of these objectives as corollaries of the establishment of a common market for agricultural commodities would call for international agreement on certain regulatory devices. For example, it might be found necessary to reach international agreement on minimum prices, to provide that countries might stop imports of particular commodities when their prices fell below the minimum agreed in advance and to organise a special European agency for agriculture with a view to negotiating and operating the special provisions which would govern a common European market both during and after the transition period. During the transition period countries might further be permitted to bring domestic prices into line with the agreed minimum price for international transactions by the levying of compensatory duties or the payment of subsidies to domestic producers.

CHAPTER V

SOCIAL POLICY IN A RÉGIME OF FREER TRADE

204. In the previous chapter we have examined the question whether and to what extent it might be necessary, in order to create conditions of effective international competition in a freer market, to reduce international differences in social conditions and policies through a process of harmonisation concomitantly with the reduction of trade barriers during the period of transition. For the purposes of the present chapter we assume that the transition period has been completed and that a régime of substantially freer trade covering a group of European countries has been established. We proceed to consider how far it may be necessary or desirable in such a régime to provide for further international co-ordination or harmonisation of national policies aiming at the improvement of social conditions.

General Arguments for International Co-ordination of Social Policies

205. It may be useful to begin by distinguishing between non-economic and economic arguments in favour of concerted international action in the field of social policy. Non-economic arguments include the argument that international discussion of social problems can stimulate a desire for social progress and can help to point the way towards such progress by enabling some countries to profit by the experience of others. International recommendations addressed to governments, employers' organisations or trade unions carry weight and influence opinion. If international agreement can be reached that the introduction of certain types of social measures is desirable, this will strengthen the hands of those who, in the various countries, are pressing for the introduction of the measures in question. Thus international action can supplement and strengthen efforts which are being made at the national level to bring about improvements in social conditions. It is clear that national legislation and social policy have in many cases been ad-

justed to the requirements of I.L.O. Conventions and Recommendations, which have thus provided a stimulus to the achievement of ends which are agreed to be socially desirable.

206. At the same time there are in our view limits to the degree to which harmonisation of social policies is desirable. The most important of these limits probably is the existence of differences in national preferences and customs as regards the objectives and methods of social policy. An obvious example of national custom and tradition is the number of annual paid public holidays. As to preferences, in some countries the majority of the population may judge that adequate provision for low-cost medical care or liberal family allowances is of such social importance that the government should assume full responsibility for it, not only in respect of wage earners but for the whole population. But in other countries only more limited schemes may be found desirable. Again, the length of working hours which gives the most preferred combination of goods and services plus leisure may not be the same in countries with, for example, differing levels of real income. Where there clearly are differences in national customs and preferences there would not seem to be any strong case on purely social grounds for the harmonisation of social policies.

207. The main economic argument for concerted international action in the field of social policy is that in the absence of international co-ordination the efforts of some countries to introduce improvements in social standards and conditions may be frustrated by the competition of other countries with a less developed social conscience. This economic argument, to the extent that it is sound, strengthens social arguments for harmonisation in cases where there is general agreement on the desirability of certain social measures, and may provide a reason for attempting some degree of harmonisation even in respect of matters of social policy to which different countries attach substantially different priorities. In such cases it would evidently be difficult or impossible to achieve harmonisation in matters of detail, but it might be necessary and sufficient to secure agreement on certain broad principles of policy.

International Levelling of Social Standards

208. The economic argument for harmonisation of social policies, when there are international differences in labour costs or taxation during the period of transition, has been examined in

Chapter IV. The question there discussed was whether such differences constitute obstacles to the establishment of a régime of freer trade, and should therefore be eliminated or moderated in the period during which such a régime is being instituted.

209. Our analysis of this problem should also dispose largely of another question which is sometimes raised, namely whether the persistence of international differences in labour costs as a permanent feature of a régime of freer trade would impair the proper functioning of such a régime. In this connection one sometimes hears the argument that unless "harmonisation" brings about a levelling up of labour conditions, the establishment of a régime of freer trade will exert pressure towards a levelling down, since the substantial international differences which prevail today in labour standards in the same industries will, it is felt, be difficult to maintain in the face of the competition that would prevail in a régime of freer trade. However, if, as we maintain, countries with higher general levels of labour cost per unit of time can as a rule compete freely in a common market with countries having lower general levels of labour costs, there is no economic reason why the establishment of a common market should lead to a levelling down of labour standards in the former group of countries, even though international differences in such standards may be reduced and even though the strength of some monopolies would be weakened.

210. There would, under freer trade, be some tendency towards an equalising of factor prices and earnings, inasmuch as countries would tend to specialise in the production of commodities using relatively large proportions of their least scarce and therefore relatively cheapest factors of production. Thus, countries in which labour was relatively cheap would tend to specialise more than at present on labour-intensive types of production, thus raising the demand for and earnings of labour relatively to those of other factors. In other words, while the level of living of workers in high-wage countries would continue to rise, that of workers in lower-wage countries would tend to rise more rapidly. This tendency, however, is relatively weak and would not by itself lead to anything near equality in standards of living between countries : if it were desired to bring about quickly a considerable reduction in existing international differences in living standards, it would be necessary to have recourse to substantial international movements of labour and capital. More important than this tendency in its effects on workers' living standards, we believe, would be the more

rapid growth of productivity to be expected as a result of the more efficient international division of labour. This would be amply sufficient, in our view, when account is taken of the strength of the trade union movement in European countries and of the sympathy of European governments for social aspirations, to ensure that labour conditions would improve and not deteriorate.

211. There is a widespread feeling that labour standards within a European common market should be levelled up internationally; for example in Article 3(e) of the Treaty instituting the European Coal and Steel Community the institutions of the Community are charged with the task of improving conditions of life and work of labour so as to permit their "equalisation in an upward direction" in the industries of the Community. At the same time Article 68 of the Treaty declares that the methods of wage fixing and systems of social benefits applied in the member States are not affected by the Treaty except in special cases.[1] We understand that the question of how, in these circumstances, the institutions of the Community could contribute to the upward levelling of labour standards is under active consideration by the High Authority. We have also noted and find ourselves in general agreement with one view which has been expressed on the question of upward levelling of conditions of life and work in the common market of the Community, namely that "this upward equalisation must essentially be the result of the functioning of the common market itself, provided that the rules of competition, especially those in respect of wages, permit the economic mechanism to bring about this result".[2]

Improvement of Labour Standards in a Common Market

212. The view that a substantial measure of "harmonisation" of social policies will be necessary in a régime of freer trade is sometimes supported by an argument which looks not to past or

[1] Namely, when abnormally low wages (i.e., wages abnormally low "having regard to the level of wages in the region concerned") are a cause of abnormally low prices, when reductions in real wages are used as a means of permanent economic adjustment or of competition between firms or when one country causes a grave disequilibrium in the common market by altering its methods of financing social security or of combating unemployment.

[2] Ministère des Affaires étrangères : *Rapport de la Délégation française sur le Traité instituant la Communauté européenne du charbon et de l'acier.* (Paris, October 1951), p. 130.

present differences in labour costs but to the future. Any one country wishing to introduce certain improvements in the living standards of its workers [1], either in general or in a particular industry, will, it is argued, find it harder than at present to do this if it is exposed to the competition prevailing in a régime of freer trade. Such a régime, the argument continues, may thus constitute an obstacle to further social progress unless this can be achieved through measures taken in common by the whole group of countries.

213. When considering this argument it is essential to remember that under the present pattern of production and within the present régime of protection the various European countries are in fact competing vigorously against each other. The range of goods traded, the prices at which, and the markets in which they compete are different from what they would be in a régime of freer trade, but the competition is there. This competition has not kept social standards in all countries down to the levels prevailing in the countries which are socially most backward, nor has it prevented particular countries from raising their social standards even when other countries have not done likewise. The main reason why it has been possible to raise workers' living standards despite international competition has, of course, been the growth of productivity, and the main reason why it has been possible to do so faster in some countries than in others has been that productivity has grown faster in some countries than in others. The growth of productivity, and differences in the rate of growth of productivity in different countries, can be counted on to persist in a régime of freer trade, and will continue to create opportunities for raising social standards in all countries in which such growth occurs.

214. It may nevertheless be found desirable and possible to "harmonise" to some extent action for the improvement of workers' living standards. When most obstacles to international trade and the possibility of introducing such obstacles have disappeared, workers' remuneration in terms of money cannot rise at very different rates in different countries so long as rates of exchange remain stable, except in so far as productivity increases faster in some countries than in others. Therefore, if workers in a particular industry in some countries are weakly organised or for some other reason are unable to obtain wage increases in step with rising

[1] We use this phrase in a broad sense to include not only those elements in living standards which are determined by the level of wages proper but also such items as holidays with pay, net social benefits and so on.

productivity, the improvement of labour standards in the same or competing industries abroad may also be hampered. In such circumstances it would be desirable to create conditions for effective collective bargaining or, failing that, machinery for the statutory fixing of minimum wages in those cases where labour bargaining power is weak.

215. The establishment of freer international markets may, however, in itself provide at least a partial solution to this problem. Employers' and workers' organisations in the participating countries will undoubtedly be keenly aware of the need in a freer European market for a parallel development in levels of costs and workers' remuneration in accordance with increasing productivity. Consequently, the establishment of wider markets may be expected to foster the development of international contacts among trade unions and employers' organisations representing the same industry in different countries. Such a development might be of assistance both in safeguarding the workers' right to a fair share in the benefits of increasing productivity and in reducing the risk of excessive increases in money wages, costs and prices which otherwise might lead to inflationary pressure in certain countries.

216. As regards the possible need for international co-ordination of governments' social policies, it follows from our analysis that in general any country participating in a common market may raise its labour standards at a rate such that the rate of increase in the general level of labour cost per unit of time roughly corresponds to the rate of increase in over-all productivity without causing any general weakening of its competitive strength. [1] Within this limit there does not seem to be any economic necessity for international harmonisation of social policies in general. The nature of the improvement in labour standards, whether this takes the form of shorter working hours, increased holidays with pay or increased weekly earnings, an earlier age of retirement or higher pensions would, from the point of view of international competition, be in many cases a matter of relatively small importance. It is true that in capital intensive industries a reduction in working hours may have effects which differ considerably from those of wage increases ;

[1] This does not mean that we believe that workers' average living standards should or could in all circumstances rise in exactly the same proportion as the increase in productivity. In some cases workers' living standards may rise faster ; in other cases they may have to increase at a somewhat slower rate.

but as we have said in paragraph 74, the country concerned nevertheless stands to gain from the benefits which follow from international trade.

217. But general measures of social policy may affect different industries in a different fashion. For example, a general ban on night work or on work on Sundays might affect most industries in the country concerned to roughly the same extent and in roughly the same way, but there might be a few industries whose costs of production and international competitive position would be strongly affected.[1] If such industries were engaged in vigorous international competition the effect of such measures might very well be to force them to contract or to disappear altogether even though in other respects they were quite sound.

218. If a group of countries were agreed on the need to introduce some general improvement in their social and labour conditions which would have such serious disturbing effects in certain industries, or if they wished to introduce some improvement in a particular industry (for example, increased compensation for victims of silicosis), they might well invite other countries belonging to the common market to take similar steps at the same time.

219. If there were a strong measure of agreement among the community of countries in favour of introducing the improvement in question, but a minority of countries were to hold out against doing so, a country whose interests were considered to be injured or threatened might be authorised to take special steps to protect itself from competition from such countries. However, it would seem desirable, in order that a country should not be judge in its own cause, that the circumstances in which special protective measures would be permitted should be defined in general agreements.

220. Where a substantial measure of agreement in principle in favour of introducing a certain type of social measure was found to exist on the part of a community of European countries participating in a régime of freer trade, consideration might be given to the desirability of defining minimum standards in international

[1] For example, in Netherlands ports no work on Sundays is permitted except in unusual circumstances ; in German ports resort to Sunday work is much more frequent. In view of the high cost involved in idle time of ships the more liberal system practised in German ports probably gives the latter an advantage compared with competing ports where a more restrictive system of working time is applied.

labour Conventions designed especially to apply to European countries. Such Conventions would, however, undoubtedly have to be framed in very general terms, for countries would need to retain a considerable degree of freedom in organising new measures of social progress in accordance with national needs, preferences and traditions. The purpose of such co-ordination of national policies would, as we see it, be to ensure that minimum conditions for satisfactory social progress were met and to eliminate international competition based on a country's failure to respect internationally agreed standards, and not to bring about a maximum of uniformity between countries.

Co-ordination of Economic Policies

221. While the need for detailed co-ordination of national social policies in a régime of freer trade may be less than is sometimes believed, we are of opinion that the smooth working of such a régime would be greatly facilitated, and important general social advantages attained, if general agreement could be reached on certain broad principles of economic policy.

222. One such principle might be that governments should seek to maintain approximate stability of national price levels. [1]

223. Increasing productivity may be reflected in falling prices with stable money wages or in rising money wages with stable prices, or in some combination of the two. We believe that it is usually preferable, at least in economies which are not centrally planned, that average money incomes should increase more or less in step with the average increase in productivity in the economy as a whole. [2] It is probably easier to avoid fluctuations in total effective demand with a stable than with a falling price level. Moreover, in the long run, stable prices and gradually rising money wages and social benefits are likely to be more in line with the traditions of the trade union movement and, indeed, with many aspects of widely adopted economic and social policies than are falling prices

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[1] At certain times world-wide forces may exert strong pressures making for rising or falling prices. At such times it might in certain circumstances be preferable to aim at ensuring that national price levels should move in harmony with each other rather than that they should all remain stable.

[2] This does not mean that money wages in each separate industry should rise in the same proportion as productivity in that industry, for this would involve a gross distortion of the wage structure since opportunities for increasing productivity are much greater in some industries than in others.

and stable money wages. Thirdly, it is doubtful whether entrepreneurs in industries where productivity increases relatively rapidly will lower their prices to an extent sufficient to enable the average price level to fall significantly without forcing price reductions in other industries in which, for one reason or another, productivity cannot be increased as rapidly as the average. [1]

224. In a régime of freer trade it will, however, be more difficult for any single member country to raise money incomes in step with increasing productivity if in some other country a policy of stable money incomes and falling prices is pursued. When there is less protection, and less freedom to increase protection, employers will have stronger grounds for resisting demands for higher wages if in another country wages are not raised. It is, in theory, possible to enable participating countries to pursue divergent policies in this respect by permitting them to revise their rates of exchange from time to time as may be necessary. But, as we have said, it seems undesirable that a country should have recourse frequently to such a drastic measure.

225. These problems become more acute if in one or a few countries productivity increases more rapidly than in the majority of the trading nations. If, in a country with rapidly increasing productivity, money incomes do not rise more or less in step with productivity, its export prices will fall and other countries will have to adopt a policy of deflation or adjust their rates of exchange. Both courses are usually, though perhaps not equally, undesirable.

226. It would seem, therefore, that a régime of freer trade could be operated more easily if the participating countries agreed on the principle that the price level should, as a general rule, be kept approximately stable, which would imply that money wages and social benefits should increase in step with average productivity.

227. Perhaps the emphasis in this sentence should be on the words "as a general rule". There are, indeed, circumstances in which it would seem appropriate to permit departures from this principle. For example, even when productivity increases more or less uniformly in all participating countries, total production may increase substantially faster in some than in others, because the

[1] For a fuller discussion of this question, see I.L.O. : *Higher Productivity in Manufacturing Industries*, Studies and Reports, New Series, No. 38 (Geneva, 1954), pp. 26 ff.

working population increases more rapidly or because a substantial volume of open or disguised unemployment is being eliminated in a country in process of economic development. If in such countries an increase in output requires a large increase in imports of raw materials, these countries must expand their exports at a relatively fast rate too. It may therefore be necessary for them to reduce their prices compared with those of other countries—for example, by letting money incomes rise less rapidly than productivity.[1] Or a country may find that, although its average productivity is increasing at the same rate as in other countries, foreign demand for its products is falling because of the appearance of substitutes or because productivity in its main export industries rises less rapidly than the average in all its industries taken together. In such cases balance of payments difficulties would be encountered if wages in the export industries rose in step with average productivity.[2] Thus, if the principle that prices should be kept approximately stable and that wages and social benefits should increase in step with productivity were adopted, the principle would have to be applied in a flexible way and with adequate provision for consultation in the event that one or more countries encountered particular difficulties in complying with it.

228. Agreement on certain principles of policy aiming at maintaining a high level of production and employment would also acquire added importance in a régime in which governments had given up (at least vis-à-vis other participating countries) such freedom as they now retain to raise tariffs or impose other obstacles to trade for the purpose of protecting their economies against deflationary pressures and threats of unemployment emanating from abroad. There may not be any need for governments which have accepted the obligations as regards full employment laid down in the United Nations Charter and in the Declaration of Philadelphia to subscribe to new agreements in this field of policy, apart from an agreement in principle to aim at maintaining approximate stability of national price levels. But the methods to be adopted, within a régime of freer trade, to give effect to existing undertakings regarding the maintenance of a high general level of

[1] The need to provide employment opportunities for a rapidly increasing working population, together with a heavy dependence on foreign trade, is one of the major reasons why in the Netherlands the Government continues to keep wages under rather stringent control.

[2] In some cases of this nature devaluation of the currency might, however, be an appropriate way of dealing with these difficulties.

employment would seem to be a fruitful subject for discussion between participating governments.

229. As is well known, different types of unemployment have different causes and call for different remedies. For the prevention of cyclical or general unemployment we agree that main reliance must be placed upon fiscal and monetary policies (including the undertaking of public works) designed to maintain an adequate level of effective demand from the private and public sectors of the economy taken together. If aggregate demand is to rise steadily it is necessary either to stabilise each element in aggregate demand—private consumption demand, private investment demand, public demand for current goods and services, public investment demand and the foreign balance—or to compensate for unavoidable fluctuations in any one or more sources of demand by inducing counteracting variations in other sources of demand. Of these various sources of demand the demand for exports is least subject to influence by the Government of the country concerned. Unforeseen fluctuations in the demand for its exports may make it exceedingly difficult for a country to maintain full employment, particularly if it has forgone its freedom to indulge in the palliative of raising import duties. A slump in exports may sometimes arise from a change in tastes or requirements, or from the emergence of new sources of supply, but experience has shown that the main danger to any one country's exports is a failure on the part of other countries to maintain a high level of income and employment. Each country participating in a régime of freer trade would have enhanced responsibility towards other countries for avoiding the setting in motion of a deflationary (or inflationary) spiral which would spread across national frontiers.

230. It would seem desirable that, when taking action to this end, countries should consult with each other in order to achieve a measure of co-ordination in national policies designed to avoid sharp fluctuations in prices and employment. This is the more important because inflationary or deflationary impulses may emanate from outside Europe : if each country attempted to cope with such exogenous disturbances on its own the result might be that either the operation of a freer market in Europe would be disrupted or the measures taken in one country would be rendered ineffective by conflicting action in another country. Concerted policies for economic stabilisation might even go beyond the mere co-ordination of national policies ; in certain cases, for example, it might be found

possible and advantageous to undertake compensatory public works on an international scale. [1]

231. Another type of unemployment that may create difficulties in a régime of freer trade is so-called frictional unemployment, due to difficulties and delays in adjusting the supply of labour in different occupations, industries and areas to changes in demand. Transitional problems have been discussed in Chapter IV, but the problem is not simply that of a once-for-all transition to a régime of freer trade. The smooth working of such a régime, once it is established, will probably require a higher degree of mobility of factors of production between occupations, industries and areas than has prevailed in the past ; for each country, to the extent that it renounces its freedom to raise import duties or impose other barriers to trade, will have weakened the power—admittedly limited—which it retains at present to insulate its economy from the effects of disturbing shifts in demand or supply emanating from abroad. Well-functioning and comprehensive employment services, retraining facilities and removal grants or similar financial arrangements, together with the undertaking of suitable public works, will be important not only during the transition to a régime of freer trade but also after such a régime has been established. The movement of workers to new jobs will also be facilitated if arrangements can be worked out to enable them to carry with them acquired seniority and pension rights. These are matters requiring the closest consultation and co-operation between governments, employers or their organisations and workers' organisations within each country. In addition, international discussions on these questions would, we believe, be helpful in any régime of freer trade, and indispensable if international co-operation included arrangements to promote freer movements of labour between countries. The Governing Body will no doubt wish to give consideration at the appropriate time to ways in which the machinery and experience of the I.L.O. might be used to facilitate such international discussions and co-operation.

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[1] It may be recalled that as early as 1937 the International Labour Conference adopted a Recommendation concerning international co-operation in respect of public works.

CHAPTER VI

INTERNATIONAL MOVEMENTS OF LABOUR AND CAPITAL

232. We have already touched upon certain aspects of international movements of labour and capital in Chapters I, II and IV, discussing in general terms the role of such movements, first within the general framework of economic co-operation in Europe and secondly in connection with problems of transition to a freer market for commodities. In the present chapter we discuss in more detail the present conditions governing the migration of manpower and the movement of capital, and comment briefly on certain problems which a substantial reduction in existing obstacles to free movement of these factors might encounter.

Freer Movement of Labour

233. In discussions concerning closer economic co-operation among European countries it is commonly considered that freer international movement of labour is a desirable or even a necessary corollary of the liberalisation of commodity trade. For example, in the Convention for European Economic Co-operation of 16 April 1948 members of O.E.E.C. undertook to co-operate in the progressive reduction of obstacles to the free movement of persons (Article 8). In the second annual report of the Organisation for European Economic Co-operation (February 1950) "a reasonably free flow of labour between nations" was described as "a desirable accompaniment of the free flow of goods and services in a multilateral trading system". The report continued : "The freeing of intra-European trade which is now one of the principal tasks of the Organisation should therefore be accompanied by greater and freer movement of labour between participating countries. At the same time, in countries in which there is a surplus of manpower the problem of adjustment to measures for the freeing of trade may be a particularly serious one."[1] In another report "greater freedom for people to move across national frontiers" is considered "an essential

[1] O.E.E.C. : *European Recovery Programme,* Second Report of the O.E.E.C. (Paris, Feb. 1950) p. 213.

step for assuring the economic and political strength of the Western world. There is urgent need to remedy the existing manpower disequilibrium in which full employment and labour shortages in some countries co-exist with heavy unemployment in others. The first line of attack on heavy unemployment is the absorption of more manpower at home; but in countries where the problem cannot be fully solved in this way an increased movement of workers to other countries is essential. Member countries of the O.E.E.C. have the responsibility of achieving the maximum possible freedom of movement among themselves."[1]

234. Under subsequent decisions most of the member countries have agreed to grant work permits in respect of nationals of other member countries unless *(a)* a "suitable" worker for the job in question is found within the country; *(b)* the foreign worker is not "suitable"; *(c)* for "imperative reasons of national economic policy" the addition of foreign workers to the labour force in the industry or occupation in question is considered undesirable; *(d)* the wages and conditions of employment are unsatisfactory; or *(e)* industrial peace would be endangered by the granting of the permit. However, according to the Organisation's sixth annual report "no great results have up to now been achieved in reducing obstacles to the international movement of labour. In this field the restrictive spirit is still wide-spread".[2]

235. Members of the European Coal and Steel Community have undertaken under Article 69 of the Treaty to permit free movement of workers of confirmed qualification in the coal and steel industries. This undertaking has been interpreted as contributing to economic expansion, the development of employment and the raising of living standards in the member countries, which are among the general objectives of the Community laid down in Articles 2, 3, 4 and 5 of the Treaty[3] and as an essential instrument for achieving the objectives of continuity of employment and of equalising progress in conditions of living and work.[4] It has,

[1] O.E.E.C.: *Europe—The Way Ahead,* Fourth Annual Report of the O.E.E.C. (Paris, Dec. 1952), p. 30.

[2] Idem, *From Recovery Towards Economic Strength,* Sixth Report of the O.E.E.C. (Paris, Mar. 1955), Vol. I, p. 19.

[3] Communauté européenne du charbon et de l'acier, Assemblée commune: *Rapport fait au nom de la Commission des affaires sociales,* Document No. 14, 1954-55 (Mar. 1955), p. 10.

[4] Idem, Haute Autorité: *Troisième rapport général sur l'activité de la Communauté (12 avril 1954-10 avril 1955)* (Luxembourg, 10 Apr. 1955), p. 166.

however, been complained that member governments have given too narrow an interpretation to Article 69.[1]

236. In Northern Europe, under a Convention of 1954 between Denmark, Finland, Norway and Sweden, nationals of the participating countries no longer need work permits and the national labour services work closely together in operating what is practically a common labour market. It is generally agreed that experience with this policy has been favourable. Measures have also been taken to ensure equal treatment, on a basis of reciprocity, of nationals from these countries in respect of social security and welfare schemes. While formal arrangements to that effect have not yet been concluded among the Benelux countries, a substantial freedom of movement of labour exists in practice within the area of the union. In other countries where labour permits are still required, there is a decided tendency towards the extension to immigrant workers of the same rights to social security benefits as are available to nationals.

237. The actual volume of net migration for employment within Europe since the war (not including movements of refugees) has been of the order of magnitude of 1 million permanent migrants. Some foreign labour moved to Belgium (particularly coal miners), France (where shortages of labour have been met to a large extent with North African labour), the United Kingdom (mainly displaced persons and Irish workers), Sweden (largely from other northern countries) and Switzerland. It seems that, on the whole, most industrialised European countries have not experienced any acute general labour shortage although shortages of particular types of labour have occurred. Although the migration has been limited in volume it has rendered a very useful service—for instance in coal mining, agriculture and the construction industry. It has not of course been on a scale sufficient to alleviate substantially the situation in the overpopulated countries of southern Europe.

Obstacles to Migration

238. International movement of labour generally encounters serious difficulties. The obstacles to migration of labour in Europe are twofold : first, workers are seldom keen to move away from

[1] Idem, Assemblée commune : *Résolution relative aux questions sociales*, in Document AC. 1492 (mimeographed, Luxembourg, 23 May 1955), pp. 8-12.

their own country ; and secondly, when they do make up their minds to move they face restrictions on entry to and employment in the country to which they wish to go.

239. Most Western European workers appear to be reluctant to change their occupation or place of employment. They consequently view with some apprehension the possibility that schemes for higher productivity or freer trade may lead to changes in the over-all pattern of employment and may thus make it necessary for some workers to change their jobs. The extent to which the objective of full employment is interpreted as implying security of employment in the same job and in the same place has sometimes amazed outside observers. For example, an American author was struck by the fact that "it is not unheard of for European employers to refuse lucrative new business on the ground that it would require adding to the work force new workers for whose continued employment the employer would then be legally or morally responsible. Conversely, unemployment tends to mean patient waiting for a new job in the same occupation and same area without consideration of the possibility of moving to an occupation or area of more active demand." [1]

240. But perhaps even more important is the resistance often shown by workers to the admission of foreign labour. This resistance appears to be due in part to a certain antipathy based on strangeness and differences in language, religion and history. The population of Europe is far from homogeneous and the obstacles to international movement of labour which result from this fact can only be overcome by a gradual process of education and the interchange of people and ideas, for example through tourism and the exchange of students, teachers and workers. A second reason why the admission of foreign workers is not normally welcomed is the very strong preoccupation with security of employment which, it is feared, may be threatened by the admission of foreign entrants into the national labour market. Thirdly, there is the fear that migrant labour will depress the domestic wage level. In many countries the problem has been further complicated at times by housing shortages. Potential immigrants have been afraid that they might be unable to find a house, and people in the country to

[1] David E. CHRISTIAN: "Resistance to International Worker Mobility. A Barrier to European Unity", in *Industrial and Labor Relations Review* (Cornell University, Ithaca, New York), Vol. 8, No. 3, Apr. 1955.

which they want to go fear that their coming will accentuate the housing shortage.

241. Another factor limiting the volume of migration is the shortage in countries of emigration of certain categories of workers —e.g. skilled workers for metallurgy and the metal trades—which the countries of immigration would be ready to accept. Vocational training programmes may provide a remedy for this difficulty.

Migration and the Problems of the South

242. Any further discussion of freer international movement of labour in Europe must take as its starting point the existence, on the one hand, of large unemployed and underemployed resources of manpower in the south and, on the other, the substantially higher levels of employment and income in the areas north of the Alps. Throughout the post-war period when arrangements for international co-operation in Europe were being negotiated, the desire of the southern European countries, and of Italy in particular, to find an outlet for their surplus labour through migration to the northern countries has been a key issue. In the more prosperous countries, however, resistance to the admission of foreign workers has seriously restricted the practical possibilities of meeting the problems of the southern countries.

243. Broadly speaking, the present situation is one in which agreement on the migration of surplus labour can be reached only in respect of the types and numbers of workers whom the industrialised countries find it advantageous to admit, taking into account their immediate national interests and the limited extent to which their own workers are willing to agree to the admission of immigrants. The purposes for which fully employed high-income economies may find it in their interest to agree to immigration include particularly the need to overcome temporary or local labour shortages and to man certain occupations to which domestic workers do not feel attracted or for which there are long-term labour shortages. The former case gives rise to short-term movements of labour which are often not very satisfactory from the point of view of the migrant workers and their countries. In Switzerland, for example, where large numbers of foreign workers, especially Italians, have been temporarily admitted in periods of labour shortage their work permits have not been renewed when employment opportunities deteriorated : the immigrants come in last on the labour market

and they go out first.[1] The situation is somewhat more stable if the immigrants find employment in occupations which are avoided by the national population because they are of an unattractive nature. Classical examples are domestic service and coal mining ; coal mining in particular is apparently becoming an occupation from which workers in fully employed high-income economies turn away, leaving their places to be filled by immigrants.[2] In certain European countries (France, Luxembourg and Switzerland) significant numbers of foreign workers have also found employment in agriculture and in the construction industry.

244. It is doubtful whether much more can be expected by way of agreement on free international movement of labour unless the basic purposes to be achieved through closer economic co-operation are conceived somewhat more broadly than has so far proved possible. We would expect that once concrete results have been achieved in other fields of international economic co-operation, for example a substantial reduction in trade barriers, countries will gradually come to adopt a more flexible attitude towards the question of admitting foreign workers and we would consider this to be a desirable concomitant to freer international trade ; even so it is not to be expected that migration from southern Europe would take place on a massive scale and in any case such migration could offer only a partial solution of the problem of the south.

245. The true solution to the problem of the overpopulated areas in the south lies in the creation of additional employment opportunities within these countries. This will, of course, require a large volume of investment, but the absorption of immigrant workers in other countries also requires substantial investment and perhaps even more. We consider, therefore, that co-operation by

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[1] For example, when in 1949 industrial employment in Switzerland fell by 8 per cent., unemployment rose by only a few thousand. The reason was that the fall in employment mainly affected Italian workers who had their employment terminated and returned to their own country. (United Nations, Economic Commission for Europe : *Economic Survey of Europe in 1949* (Geneva, 1950), p. 62.)

[2] For example, in 1954 in Belgium, of a total of 150,000 coalminers, 61,000 were foreigners. In France, gross immigration of miners during the years 1946-54 amounted to about 57,000. In the United Kingdom, however, even temporary recruitment of Italian miners has met with resistance from the trade unions. For example, in 1951, a scheme for the employment of 6,000 Italian workers was agreed upon, but only 1,500 Italians arrived in the United Kingdom, and as soon as they had to leave the language courses for actual work in the mines difficulties arose with local trade unions. The experiment was given up and the vast majority of the miners returned to

the more well-to-do countries in solving the problems of the south should take the form in large part of capital loans rather than of agreement to the admission of large numbers of migrants. In Chapter II we have argued that industries can probably be established in the overpopulated areas provided that the necessary capital is made available, that active steps are taken to improve communications and other public facilities and workers' skills, and that certain measures of commercial policy are adopted in order to take account of the discrepancy between money and social costs of production in these areas.

246. When there are shortages in underdeveloped countries of technicians and professionally trained persons, immigrants with such qualifications may make a contribution to economic development out of all proportion to their numbers. The migration of technically and professionally qualified persons may be particularly important in order to get the best results from international capital movements. The effective use of new capital in an underdeveloped country often requires considerable numbers of technically and professionally trained personnel. In some cases, however, differences between countries in the requirements for licences to practise certain professions have proved a deterrent to the migration of highly trained workers. For cultural and historical reasons there may be also in some underdeveloped countries a shortage of organisational and entrepreneurial skills. These shortages, as well as those of the technically and professionally trained, might to some extent be filled by migrants from economically developed countries.

247. To sum up, we consider that mass migration from the overpopulated areas should not be one of the objectives of freer international movement of labour. The effects of such mass migration both on the countries of emigration and on the countries of immigration are uncertain and it is hard to foresee the social problems to which it may give rise. On the other hand, we believe that freer international movement of labour on a more limited scale would be useful for some of the other purposes which we have mentioned above, such as overcoming temporary labour shortages and manning unattractive occupations in the industrialised countries, and increasing the supply of technical, professional and organisational skills in areas where such qualifications are scarce. It is desirable that such mutually advantageous movements of workers should not be prevented by narrow interpretations of regulations whose real purpose is to avoid mass immigration, nor

should they be unnecessarily hampered by excluding immigrants from the social security and welfare benefits to which nationals of the receiving country are entitled. Certain of the principles embodied in the I.L.O. Migration for Employment Convention (Revised), 1949 [1] point to the way in which this end might be achieved—notably those relating to co-operation in appropriate cases between the employment services of different countries and to the treatment of immigrants on terms no less favourable than those applied to nationals in respect of remuneration and social security.

International Capital Movements

248. International capital movements may take a variety of forms and may serve a large number of different purposes. For example, short-term private loans may be granted by exporters to their foreign customers as a normal way of financing international trade. Short-term public lending is a common means of tiding over seasonal and other temporary deficits and surpluses in international payments between central banks. Long-term private capital transactions may be of the portfolio investment type, that is the buying and selling of shares and bonds in foreign enterprises or from foreign governments, or of the direct investment type, firms which operate in one country establishing a branch or subsidiary or an independent new enterprise in another country. Long-term public capital transactions may be instrumental in assisting governments in the economic reconstruction of their countries, in defence, or in the development of unindustrialised areas.

249. There is no need for us to go deeply into the numerous and very complicated problems relating to international capital movements. Some long-term effects of such movements have been mentioned in Chapter II, and some of the contributions which they might be expected to make to the alleviation of problems of transition were discussed in Chapter IV. In the following pages we draw attention to some relationships between the liberalisation of trade and the lifting of restrictions on capital movements, and between such movements and international differences in social policy.

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[1] This Convention has been ratified, *inter alia*, by Belgium, France, Italy, the Netherlands, Norway and the United Kingdom.

Private Capital Exports and Freer Trade

250. Private exports of capital in Europe have been at a low level ever since the international capital market broke down in the early 1930s. This has been the result partly of a reduced inclination on the part of potential investors to lend or invest abroad and partly of their being prevented by exchange controls from exporting capital even if they wished to do so. On the one hand, political and monetary instability, together with the unpredictable nature of government intervention in economic affairs, have created a feeling of insecurity on the part of capital owners who fear, rightly or wrongly, that investments abroad may be subject to increased taxation, expropriation or nationalisation, restrictions on the right to repatriate capital or to transfer dividends, devaluation, or other risks which tend to make international investment less attractive than investment at home, especially where through protective policies domestic investment is made more secure and profitable than it otherwise would be. On the other hand, foreign lending and investment have been limited in a large number of countries which apply exchange controls in the interest of maintaining balance of payments equilibrium or for other purposes.

251. In these circumstances private international investment across European frontiers before and since the war has been rather small and insignificant. It appears that since the war a certain amount of direct investment has taken place, for example between Belgium, France, Italy, the Netherlands and the United Kingdom, a high proportion of which has been in connection with the refinery and marketing operations of oil companies. Some larger amounts have been involved in private investment within particular monetary areas, for example between the United Kingdom and other members of the sterling area, between France and its overseas territories and between Belgium and the Belgian Congo. [1]

252. A liberalisation of commodity trade may be expected by itself to affect the direction and volume of private international investment in various ways. On the one hand, the establishment of a common market for commodities would tend to stimulate such investment. The liberalisation of trade would open up new

[1] O.E.E.C. : *Intra-European Investments* (Paris, 1951), pp. 13 ff.

opportunities for profitable investment of capital, from sources both inside and outside Europe, in areas where the output of particular products could be advantageously expanded. As was observed in Chapter IV, private capital movements by way of direct investment might be stimulated by these new opportunities and might thereby facilitate the transfer of capital from declining to expanding industries.

253. Another factor which would tend to stimulate private international investment would be the disappearance or substantial reduction of the risk of import restrictions in foreign countries and the cessation of protection in the investor's own country. The first of these factors, particularly if liberalisation of trade were accompanied by liberalisation of payments (which would reduce the difficulties and risks involved in repatriating capital and in remitting dividends), would tend to make foreign investment less unattractive. The second factor would tend to make domestic investment in certain industries relatively less attractive (though in others, whose export market was expanding, it would become more attractive).

254. On the other hand, trade liberalisation would take away some of the artificial causes of direct international investment which operate at present. In a protectionist world it is often more profitable to by-pass national tariffs through direct investment than to jump the tariff wall. It has been observed, for example, that the considerable direct investments by United States companies in Western Europe after the war have been primarily the result of the world dollar shortage and tariff restrictions which had virtually cut off many of the traditional foreign markets of American industry. [1]

Liberalisation of International Capital Transactions

255. The practical problem which faces governments considering arrangements for closer international economic co-operation

[1] John H. DUNNING: "United States Manufacturing Subsidiaries and Britain's Trade Balance", in *District Bank Review,* (Manchester, District Bank Ltd.), No. 115, Sep. 1955, p. 26.

A similar but economically quite sound cause of direct investment is the opportunity it offers of saving transport costs: "It has been said on good authority that ten knocked-down automobiles occupy no more space than one completely assembled. Moreover, such advantages are not confined to heavy industry: even toothpaste can be shipped so much more cheaply in bulk that it pays, on the whole, to package this product abroad." (Donald Bailey MARSH: *World Trade and Investment* (New York, Harcourt, Brace & Co., 1951), p. 499.)

is whether they should encourage any increase in private international investment which the establishment of a common market might induce by lifting existing controls on such transactions, or whether they should, on the contrary, discourage such capital movements by retaining or even tightening existing controls. We believe that it would be desirable to encourage such private investment, both in the interest of long-term economic growth and in order to facilitate the transition to a common market.

256. As regards problems of transition, the structure and methods of finance of industry being what they are it would seem much easier to effect changes in the pattern of production and employment if capital were permitted to move within the same industry from country to country than if it were necessary to rely entirely on the very imperfect mechanism of national capital markets for channelling capital resources from declining industries to expanding industries within the same country.

257. Our conclusion that it would be desirable to encourage private international capital movements is subject to an exception in the case of the undeveloped areas in southern Europe. As we have said in Chapter II, there is a tendency for industrial investment to concentrate in areas where there is already a considerable volume of industry and to avoid the areas which are most in need of industrialisation and which are not attractive to private capital because the necessary basic facilities are not available. Therefore, if it were decided to include some liberalisation of international movements of capital in plans for economic co-operation it might nevertheless be necessary to leave open to the less developed countries the possibility of keeping capital exports under close supervision, just as it might be necessary to permit them to continue a measure of protection of some new industries even under a general common market for commodities.

Capital Movements and Differences in Social Policy

258. From a more general, long-term point of view, private international investment (including direct as well as portfolio investment), subject to the qualifications set out above, may be expected to lead to an improved international allocation of capital resources. Capital will tend to be attracted to the countries and industries where its marginal productivity and hence interest or profits are

highest, and the cumulative investment of interest or profits will contribute to the economic growth of the countries concerned.

259. In this connection a question arises, similar to one we have discussed in Chapters III and IV of this report. We there considered whether international differences in social policies might not distort international differences in costs and prices and thereby distort the mechanism through which a free common market for commodity trade would allocate resources among various activities in the participating countries. The corresponding question in the case of international capital movements is whether such differences in national social policies might not lead to a misallocation of capital resources on the basis of differences in social policy rather than of real comparative advantages of investment and production.

260. To a large extent the analysis set out above can be applied to this problem too. International differences in the inter-industrial pattern of labour costs, giving a special advantage to certain industries or placing special burdens on other industries in particular countries, might lead to an excessive expansion of certain industries which might then attract excessive amounts of capital from other countries if a common market for commodities were established and, at the same time, controls on private capital movements lifted.

261. An additional problem arises, however, because private international capital movements are largely the result of international differences in the general level of earnings from capital, such as the rate of interest or the level of profits after tax. The general level of net profits in any country may be affected by taxation and other devices for the redistribution of national income, and if one country goes further or is more successful in the effective application of redistributive policies through taxation or otherwise this may be a cause of substantial international differences in levels of profits after taxes. It has therefore been suggested that "the member states of a union must somehow or other keep in step in their policies for the redistribution of income and property or else they may have to abandon the possibility of raising standards of living all round by the institution of a common market for labour and capital with freedom of movement for these factors". [1] While this reasoning needs amplification, it does call attention to a real obstacle to international capital movements.

[1] J. E. MEADE : *Problems of Economic Union* (London, Allen & Unwin, 1953), p. 77.

262. It thus appears that international differences in social policy in its broadest sense, to the extent that these differences result in significant differentials in net earnings on capital, may constitute an obstacle to the freeing of international private capital transactions, since such differences might lead to a larger export of capital than the country concerned could accept. Thus, if it were considered essential to include freedom of capital movements in arrangements for closer international economic co-operation, it might be necessary to take measures to reduce international differences in net capital returns in order to prevent a massive outflow of capital from certain countries. One method of doing this would of course be to subject capital earnings abroad to a special tax in the lending country. Another method would be to harmonise to some extent taxation or other policies in so far as existing differences therein are responsible for bringing about excessive capital movements. We cannot, however, judge how serious this problem is likely to be. Its dimensions would depend on the international differences between the actual levels of net profits and on the degree to which capital would actually respond to such differences by moving away from low-profit to high-profit countries. It is very difficult to estimate the probable magnitudes of these two factors. As regards the former, it should be borne in mind that what matters is the net effect, i.e. the ultimate incidence, of all differences in taxes and other factors affecting net profits taken together. Statistical differences in social charges alone, for example, would not throw any light on the problem because, as we have explained before, the final incidence of such charges, while practically untraceable, certainly differs from the formal financial arrangements under which they are paid. Nor would average rates of profit taxes be a reliable measure of differences in net profits because such taxes may also be shifted in varying degrees to the consumer, the worker or other groups. As regards the second factor, although, as we have suggested above, the establishment of a common market and the lifting of certain controls on international payments might stimulate international capital movements, it is uncertain whether any large volume of capital would move from one country to another if the difference in net profits was relatively slight.

263. In view of these uncertainties the best procedure perhaps would be gradually to take certain liberalising measures with respect to restrictions on international capital movements and to

watch carefully the actual size and apparent causes of such international transactions as might take place. Should it appear that differences in social policies did give rise to undesirable capital movements, measures might be taken to correct this situation. As we have indicated in Chapter V, we would expect that countries would wish to retain the largest degree of autonomy in deciding on the nature and methods of their national social policies and we would not, as a rule, expect remedial action to take the form of substantial changes in these policies; moreover, as we have suggested above, there are other and simpler means of halting an undesirable outflow of capital.

INTERNATIONAL CO-ORDINATION OF INVESTMENTS

264. Related to the question of international capital movements is the question whether the smooth working of a régime of freer trade would require deliberate attempts to co-ordinate national investment policies with a view to avoiding overinvestment in some lines of production at the cost of underinvestment in others.[1] In industries such as coal, electricity, steel and transport, investments are costly and take a long time to mature, and the costs of misdirected investment are high. Should each country proceed independently with its own investment plans in these and other fields, providing little information about them to other countries, it would be unduly optimistic to assume that market forces alone would ensure adequate co-ordination. This is, of course, not a new problem peculiar to a régime of freer trade, but hitherto it has at least been possible for governments to grant special protection to industries or branches of industries which for one reason or another have been overexpanded. Participation in a régime of freer trade would leave governments with less freedom to do this.

265. Does this mean that in a more closely integrated European economy certain investment decisions should be taken at an international level? This point of view can be supported on the ground that appropriately constituted international bodies might be expected to take a broader view and to have access to fuller information than any of the national bodies, public or private, which would otherwise be called upon to take such decisions. But experience seems to have shown that it is particularly difficult, even in the

[1] On this subject, see United Nations, Economic Commission for Europe: *Economic Survey of Europe since the War* (Geneva, 1953), pp. 222-224.

most favourable circumstances, to induce countries to hand over to international bodies the function of taking decisions regarding their investment programmes. In the early days of the O.E.E.C. much emphasis was laid upon co-ordinated planning of investments, at a time when agreements on the location of new investments could have been co-ordinated with and supported by the big inflow of capital aid from the United States. But this approach produced few practical results and was largely abandoned, the emphasis in the O.E.E.C. programme shifting towards trade liberalisation. Even in Benelux, where co-ordination of investment might seem particularly necessary, few steps have in fact been taken to bring this about.

266. But measures to co-ordinate national investment programmes need not go so far as to involve the transfer to international bodies of actual responsibility for investment decisions. What seems chiefly important is that whoever takes these decisions should do so in the light of the fullest possible information regarding present conditions and future prospects in the industries concerned. We believe it to be of the highest importance that economic co-operation in Europe should include, at least during its early stages, the provision by governments to each other on a reciprocal basis of the fullest possible information regarding investment plans and intentions in the various countries. International discussion of such information by bodies competent to make recommendations to governments, though not to take decisions, would also, we believe, serve a valuable purpose. Finally, as suggested in the E.C.E. study cited above, objective international studies of trends and prospects in demand and supply in key industries and key materials may serve as a useful guide for long-term investment decisions by business and governments.

CHAPTER VII

SUMMARY OF MAIN CONCLUSIONS

267. In the Introduction to this report we noted four main social aspects of problems of European economic co-operation as calling for investigation. In the course of our analysis we have reached a number of conclusions both on the nature of the social repercussions of closer economic co-operation and on the types of practical action which might be taken to ensure that all countries concerned will derive the maximum benefit from such co-operation. These conclusions have been stated in careful terms and with due reference to the qualifications which should be borne in mind in each case.

268. In the interest of brevity it has been necessary, in the following summary of our main conclusions, to omit many of these qualifications. We have, however, included references to passages in the report in which a fuller statement of most of these conclusions may be found, together with the analysis from which they are derived.

I. The question whether international differences in labour costs and especially in social charges do or do not constitute an obstacle to the establishment of freer international markets

269. Our conclusions in respect of this question, which is discussed mainly in Chapter III, are the following :

(i) International differences in the general level of workers' remuneration, far from being an obstacle to freer international trade, are, so long as differences in productivity persist, indispensable, though not in themselves sufficient, to ensure the allocation of manpower and capital in each country to those industries in which it has the greatest advantages or the smallest disadvantages, so as to ensure maximum output and incomes in all participating countries (paras. 99, 100, 102).

(ii) For purposes of international trade and competition it is basically immaterial in what proportions the general level of workers' remuneration and labour cost per unit of time is composed of wages proper, social charges and other elements. Consequently, the fact that the average level of social charges in one country may be higher, either in absolute amount or as a percentage of wages proper, than in other countries does not constitute an obstacle to the freeing of international trade. It is, of course, possible that substantial increases in social charges or a substantial rise in the wage level may lead to an increase in money costs and a rise in the price level of the country concerned relative to costs and prices abroad. If this relative cost increase is considerable and persists over a long period, it will become necessary to take steps to restore the competitive strength of the country concerned—for example, by measures designed to bring about a rapid increase in productivity or export capacity, or by the selection of a rate of exchange which will enable it to achieve an equilibrium in its balance of payments (paras. 91, 92, 93, 96, 99).

(iii) The situation would be different if the level of workers' remuneration (taking into account differences in skill, real effort, cost of living, etc.) in one industry (or region) were much lower than in other industries in the same country, due account being taken of differences in the nature of the work and in other circumstances that normally bring about wage differentials. In such circumstances the industry in question enjoys a special competitive advantage : it will be better able to compete in international markets than if it had to pay the level of wages and social benefits which is customary in the country concerned. It would not be in the interest of the country concerned to maintain such a situation permanently and, while other countries, if they could count on continuing to be able to import from such a cheap source of supply, would gain by doing so, there are grounds for protecting producers in other countries from competition of this kind. The figures which were available to us do not, however, suggest that serious wage disparities of this nature exist in Europe (paras. 104, 105, 106, 107, 108).

(iv) Wage differentials according to sex constitute a particular case of low wages in industries in which a large proportion of female labour is employed. When such differentials are not

the result of special circumstances affecting employment opportunities for female workers in certain areas but are due to such factors as tradition and the absence of effective organisation of female workers in trade unions, it will be desirable to create such conditions as will enable these differentials to be gradually abolished, taking into account the I.L.O. Equality of Remuneration Convention (para. 162).

II. The need for policies designed to reduce to a minimum the hardships which closer economic co-operation may involve for persons engaged in particular industries

270. When account is taken of the contribution of widening markets to the rate of economic growth and of the increasing opportunities for specialisation within particular industries and firms, the shifts in trade, production and employment which would result from the elimination of barriers to trade, for instance in the case of the establishment of a European customs union, may be less substantial than is often thought (paras. 25 ff and 112).

271. As regards the policies which should be adopted to mitigate inevitable local hardships, our conclusions are as follows :

(i) Trade barriers should be reduced gradually over a period of at least ten years so that a large part of such redistribution of labour as may be found necessary within and between firms and industries in each country could be brought about through normal labour turnover and retirement rather than through a large-scale transfer of workers from one industry or firm to another. While this would not entirely solve the problems of labour displacement it would considerably reduce their magnitude. Gradualness in the reduction of trade barriers would at the same time facilitate the adjustment of the distribution and nature of capital to changing patterns of international specialisation (paras. 133, 141).

(ii) The larger the number of commodities or groups of commodities or industrial sectors in respect of which liberalisation of trade is undertaken simultaneously, the smaller the problems of transition will be. It is therefore desirable that liberalisation be undertaken simultaneously in respect of large and balanced groups of commodities or industrial sectors (paras. 138, 139).

(iii) Difficulties of transition would be further mitigated if countries could agree on some degree of freedom—and appropriate measures of organisation—of international movement of labour and capital and if rates of exchange were permitted to fluctuate in accordance with market conditions between wider limits than at present (paras. 127, 185, 186, 188).

(iv) In order to mitigate problems of unemployment during the transition period it is important that each country should develop or maintain well-functioning and comprehensive employment services, retraining facilities, provisions for removal grants and arrangements enabling workers to retain acquired seniority and pension rights when they move from one firm or industry to another (para. 231).

(v) We believe that if appropriate policies of these types were adopted the problems of transition would be reduced to manageable proportions (paras. 144, 153).

(vi) On the whole, we would expect that the facilities and the funds necessary for the purposes set out in (iv) above could be provided by the countries themselves, with the aid, where necessary, of information and technical assistance from the International Labour Office. We are accordingly not convinced that there would be any great need in this connection for an international readjustment fund such as that which is administered by the High Authority of the European Coal and Steel Community, at any rate in the case of countries which have already reached an advanced stage of industrialisation and economic development ; but the question whether international funds might be provided to assist in the training, retraining or transfer of workers in the less developed countries is one which might be further studied (paras. 49, 153, 154).

(vii) Problems of transition in agriculture are, however, likely to present certain special difficulties. For this reason, and also because the objectives of international co-opération in the field of agriculture should extend beyond the mere elimination of trade barriers, we believe that some regulation of the markets for agricultural products will continue to be desirable to ensure reasonable stability of agricultural prices and incomes (paras. 202, 203).

III. The question whether, if a freer international market were established, it might be necessary for the countries of Europe to shape and carry out their social policies with a greater degree of international consultation and co-ordination than at present

272. We have assumed that as a general rule countries will wish to shape and carry out their social and economic policies in accordance with their national needs and preferences and that they will have recourse to international co-ordination or "harmonisation" of such policies only if there is a clear need for such action.

273. As regards the question whether harmonisation of social policies may be called for if freer European markets are established, our analysis in Chapters IV and V has led us to the following conclusions :

(i) There is reason to believe that, provided appropriate measures are taken to foster industrial development in the lower-income countries, workers' living standards in these countries will, as a result of the operation of a common market, tend to improve faster than those in the high-income countries (paras. 210, 211).

(ii) International competition in a common market would not prevent particular countries from raising workers' living standards and there is no sound reason to think that freer international markets would hamper in any way the further improvement of workers' living standards, as productivity rises, through higher wages or improved social benefits and working conditions (paras. 213, 216).

(iii) There is no reason why countries in which social and economic conditions are different should pursue identical policies in such matters as, for example, the length of the working week or the method of financing a social security scheme. We recognise, of course, that such measures of social policy, even when they are applied uniformly to all industries in a particular country, may nevertheless affect some industries more than others. When one country applies certain general measures which are applied differently or not at all in other countries the pattern of free international trade will therefore differ from what it would have been if all countries had adopted exactly the same social policies. We have analysed the case in which countries apply different methods of financing social security

and welfare schemes and conclude that even though such differences have an impact on the pattern of international trade this fact alone is not a sufficient ground for seeking to harmonise the methods in use in the different countries. Our analysis of this case can also be applied to differences in other types of social legislation which are general in their application (paras. 74, 156, 163, 166, 169, 173, 176, 217).

(iv) Nevertheless, it may be advisable to consider the possibility of some form of international harmonisation of social policies in cases where it is clearly apparent that otherwise trade would be seriously distorted and where such measures of harmonisation would not run contrary to essential features of the social policy of the countries concerned. In those cases where harmonisation may be found necessary it should not be regarded as a prerequisite to the liberalisation of trade but should be undertaken during the transition period (para. 182).

(v) In certain cases where some measure of harmonisation may be considered desirable, international consultation among employers and workers might prove of assistance in bringing about balanced improvements in conditions of life and work in different countries, in line with productivity increases, while at the same time reducing the risk of inflationary tendencies and preventing unbalanced development due to the preservation or expansion in particular areas of industries whose profitability is based on substandard labour conditions (para. 215).

(vi) We have not attempted to examine in detail the various international labour Conventions which might be of interest in this connection. We note, however, that some of these Conventions, such as the Equality of Remuneration Convention, have not been ratified by all Western European countries. We believe it would be useful to study the difficulties which non-ratifying countries have encountered in bringing their legislation into line with such Conventions and to consider what steps might be taken to promote the more widespread application of the provisions of these Conventions by European countries and thus add to their effectiveness as instruments for solving certain of the social problems connected with closer European economic co-operation (paras. 162, 181).

(vii) It is desirable that governments should seek to maintain approximate stability of national price levels, though countries

might deviate to a moderate extent from this rule in certain circumstances (paras. 222 ff).

IV. The social problems connected with freer international movement of labour

274. We have discussed this question in Chapter VI, in which we have also undertaken an analysis of the related question of freer international movement of capital. Our conclusions are the following :

(i) Some relaxation of present restrictions on migration between European countries would, we believe, be a desirable concomitant to freer international trade. International movements on a limited scale of manual and other workers could assist in meeting temporary labour shortages and in promoting the spread of technical knowledge and skills. They would thus help in overcoming problems of transition and in speeding up the process of economic growth and development (paras. 186, 246, 247).

(ii) Migration on a very large scale from the overpopulated areas does not appear to be either possible or desirable. The effects of such mass migration, both in countries of emigration and in countries of immigration, would be hard to foresee, as would be the social problems to which it would give rise. Even if these difficulties could be overcome, mass migration would offer only a partial solution to the problems of southern Europe. These problems can be solved only by vigorous economic development in this region—a development which, in turn, would benefit the whole of Europe (paras. 38, 52 ff, 243, 245, 247).

(iii) Co-operation by the richer countries of Western Europe in helping their less developed neighbours to raise their living standards should therefore take the form in large part of loans of capital to promote economic development and expand employment opportunities rather than that of admitting large numbers of immigrants from southern Europe. Another matter which might form the subject of international understandings is the conditions which should govern the use of subsidies to foster newly established industries, since the less developed countries may find it worthwhile in

certain cases to have recourse for limited periods to the use of this device (paras. 51, 245).

(iv) In order to avoid misdirection of investment and enable the available supplies of capital to make their maximum contribution to the expansion of employment and the raising of living standards throughout the region as a whole, arrangements for closer economic co-operation should include provision for studies of current trends and future prospects in key industries, for the international exchange of information concerning investment plans and programmes and for the consideration of such information by bodies competent to make recommendations to governments. Proposals for a European investment bank deserve careful study (paras. 65, 266).

PART II

STATEMENTS BY ONE OF THE EXPERTS AND BY THE CHAIRMAN OF THE GROUP

Note by Professor Maurice Byé

I. *Introduction*

No one will question the thoroughness and objectivity of the foregoing report. All who have shared with me the privilege of taking part in the work of the group will appreciate how much it owes, and how much they themselves owe, to the ability and courtesy of its chairman, to whose work every modern expert on international trade owes a great debt, as well to the goodwill and desire for "harmonisation" of views among its members and to the knowledge, patience and hard work of the secretariat.

I have made it clear that I am in agreement with many of the report's practical conclusions. I too consider that the undoubted benefits that would accrue to each European nation as a result of the integration of the economy of the continent should not be held up by an accumulation of obstacles and questions of procedure.

Neither in theory nor in practice is it possible or even desirable to achieve uniformity of social conditions. Even the less ambitious measures involved in harmonisation prove by no means useful in every field. As I share the report's view that a long transitional period will be needed, I also agree that it is inappropriate to look upon harmonisation as a prerequisite ; the adjustment should take place progressively and simultaneously.

I further agree that it is more important, if not essential, to make plans for the movement of capital and labour.

I consider in addition that the report rightly includes consideration of certain points, e.g. growth, underdevelopment, and the role of monopolies, which may involve substantial changes in the traditional analysis of international trade. In this analysis the

report is invariably at pains to be objective and to achieve agreement and mutual understanding.

I nevertheless feel obliged to put forward a number of qualifications. These are so fundamental to the analysis as a whole that I could neither wish nor expect them to be inserted in the report, as they would have impaired its unity, and thanks are due to the Committee for giving me permission to state them separately.

These qualifications are largely concerned with the fact that the report is based on a theoretical analysis, which rests on a number of hypotheses. Other hypotheses would result in a different analysis and different conclusions.

The hypothesis on which the majority of the report's conclusions are based is that there will be persistent immobility of capital and labour in the countries of Europe even after they are integrated. This immobility will be combined with specialisation by the industries of each European country in different forms of production. Nothing short of these two assumptions can justify the report's fundamental conclusions—in my opinion at least.

Of course, a number of other considerations are introduced, but in some cases this is only done by way of exception (e.g. development problems which are viewed largely from the special standpoint of underdevelopment in certain southern European regions at the present day) and in other cases by way of qualification, e.g. the extent to which the movement of capital would alter the effects that could be anticipated if the factors of production were immobile. In my opinion, however, fundamental changes are needed, based on a radically different hypothesis.

It seems to me far more likely that in a united Europe capital will be internationally mobile rather than internationally immobile. Such freedom is, moreover, advocated as an ultimate goal.

It will be appreciated therefore that as a theoretical economist I can be in broad agreement with the theoretical structure based on a given hypothesis, at the same time pointing out the consequences of other hypotheses and emphasising the most probable ones.

The hypotheses I have in mind are four in number :

(1) International mobility of labour and capital.

(2) Relative immobility of labour combined with mobility of capital.

(3) Immobility of labour and capital with partial specialisation of each economy.

(4) Immobility of labour and capital with complete specialisation of each economy.

The report in my view concentrates on the fourth hypothesis. It is, however, the second which is most likely. The first is unlikely and the third, while much less likely than the second, is more so than the fourth.

This note sets out to reconsider the hypotheses in the foregoing order and to draw the appropriate conclusions in the light of two principal factors, viz. growth and the market outside Europe.

II. *International Mobility of Labour and Capital (First Hypothesis)*

1. *Inverse Hypothesis of International Immobility of Labour and Capital.*

The report takes as its theme the long-term international consequences of a common market for goods in Western Europe.

It assumes throughout that even in the long run—

(a) What matters is the comparative level of wage costs within each nation and not their comparative level as between one nation and another (para. 269 (ii) and (iii)).

This, however, is only admissible if the volume of capital and labour available to each nation is fixed, i.e. if there is no international mobility of these factors and if there is no growth.

(b) International differences in the level of wages will persist and accordingly any measures affecting the general level of wages do not call for consideration at the international level.

This, as we shall see, is probably not true in all cases where the factors are assumed to be immobile. It is surely quite inadmissible if it is assumed that they are mobile.

2. *The International Mobility of Labour and Capital Taken as the Basic Hypothesis.*

If labour and capital were perfectly mobile between one country and another in an integrated Europe, what would happen in accordance with pure classical theory? They would tend to shift towards those geographical areas where the returns were the greatest; their earnings would tend to equality; and there would certainly be a rise in the over-all European income level.

It cannot, however, be asserted either that all the countries that lost nationals and capital would necessarily benefit thereby, or that the wage level in those countries where it is highest would not fall.

Unless the common good of Europe coincided with the self-interest of each European country it would be impossible to bring about any change by mutual agreement.

It would be necessary to await the emergence of a federal spirit such that each country, or at least some countries, would be prepared to subordinate its or their own interests to a "continental" interest.

Our Committee refused to assume the indefinite postponement of certain developments which we are all agreed in regarding as desirable.

In order to prove to each State that it is in its interest to join an enlarged European market we must therefore either prove that the hypothesis of perfect mobility of labour and capital in a united Europe is a very improbable one, or consider measures to reduce this mobility or to minimise the consequences.

3. *External Competition as an Aggravating Factor.*

The risk of very substantial shifts in the location of industry—assuming perfect mobility of capital and labour—is intensified by the relationship between Europe and the rest of the world.

European unity must expand rather than reduce trade with the rest of the world. It must avoid any search for self-sufficiency. It must endeavour to lower common customs barriers. At the same time as its production expands and its productivity rises, trade with the rest of the world will increase.

The continent will then tend to become more specialised than the aggregate of the nations composing it are at present. Some forms of production will probably be abandoned in favour of those better suited to the wider market. There is no reason to believe that the geographical location of these large-scale industries will have any relation to the present density of national populations.

4. *Spontaneous Conditions of Growth as an Aggravating Factor.*

What is known about the conditions of economic growth can only strengthen the tendency for production to be concentrated geographically—if labour and capital are perfectly mobile and if growth is left to take place spontaneously.

It is the heavily industrialised areas that spontaneously attract new investments, because of the external economies that firms achieve in these areas, the size of the markets these areas provide, the ample supplies of savings available and the research facilities that already exist there.

The development of European integration—if the foregoing hypotheses are admitted and provided no systematic counter-effort is made—would foster the growth of certain centres and might prove detrimental to certain other areas or nations.

This principle is borne out by the way in which a large-scale economy such as that of the United States has developed.

There, however, population growth coincided with industrial development and, moreover, the federal spirit was stronger than local patriotism so that the common good was defined in federal terms and neither citizens nor states raised any objection to the movement of persons or firms.

We hope that this will be the case in the Europe of the future, but in practice we can only create Europe today by demonstrating to each nation the advantages it stands to gain. That is the difference.

III. *Consequences of a Probable Imperfect Mobility of Persons and Goods (Second Hypothesis)*

5. *Imperfect Mobility of Persons.*

I readily agree with the report that even in a fully united Europe mass emigration should not be expected.

The density of population will therefore continue to vary widely.

On the other hand it should be pointed out that the total population and the working population ought not to be confused.

Emigrants are usually individuals of working age who in leaving their country of origin saddle it with the cost of supporting the old and bringing up the young. Any remittances they may send home only partially offset this cost.

6. *Imperfect Mobility of Goods.*

It is also obvious that the mere abolition of customs barriers will not be enough to turn the whole of Western Europe into a perfect market for goods and services. Transport costs and local networks of trade will remain and many goods and services will continue to be of domestic origin.

7. *Consequences of a Relative Immobility of Persons and Certain Goods Combined with Perfect Mobility of Capital.*

It is perfectly correct to say that in cases where persons do not move it is in their interest to engage in those activities involving

the minimum disadvantage. They therefore act in accordance with the principle of comparative advantages.

At the same time, however, this does not apply to capital, which I continue to assume to be perfectly mobile and which is prepared to go wherever it can be put to the best use rather than to the least unrewarding.

Thus, a population with a given volume of capital will always find a pattern of activities for which its endowment of productive resources is least unsuited. If it is short of capital it would be better advised to manufacture cigarettes than atomic products and it would be economically mistaken if it were to do the reverse.

But if the shortage of available capital is due to the export of savings and a falling off in the rate of investment (in relation to the rate of population increase) it is unlikely that the allocation of resources which is reasonable in the light of the scanty capital available will bring greater benefit than the allocation which would have been reasonable if the supply of capital had been greater.

In such a case the country will have lost rather than gained from a régime of free movement of goods and of capital.

8. *Origin and Destination of Capital Exports.*

I have assumed in section 7 that capital tended to move from the "poor" countries towards the "rich" countries. Surely this is a paradox?

Is it not true that the international movement of capital in the nineteenth century enabled the savings of the "rich" countries to be put to use in the "poor" countries?

It is a fact that in so far as there are undeveloped sources of raw materials available in the European countries or sufficiently low wages to justify the establishment of new industries such movements could still take place.

But the likelihood of this is slight : even the poorer European countries have already been explored and developed ; wages, after union is achieved, will tend to rise as a result of emigration ; lastly, European capital for the development of raw material production will find outlets outside Europe.

This phenomenon is general, and does not apply only to the existing underdeveloped southern regions. It might also apply to those regions that are now developed if their growth were to slow down or be reversed.

In the normal course of events, this phenomenon—if left to itself—will have a snowball effect. The formation of savings,

particularly in the shape of business reserves and taxation, will largely take place in the expanding regions and will naturally be put to use in those same regions.

9. *Receipts of Interest and Dividends and Their Effects on Trade.*

It may be argued that the capital-exporting countries would be able in various ways to offset the disadvantages to which they were subject.

One such way would be through the inflow of interest and dividends. But given the present policy of business with regard to reserves and the high level of taxation, only a small part of the yield will be repatriated to the country of origin of the capital. Even this part may well be reinvested abroad.

Of course the outflow of capital will always tend to produce a surplus on current account, but there will be nothing to prove that this surplus has not been obtained by a reduction (or a slower increase) in imports in step with the fall (or the slackening rise) in the national income. Moreover, interest payments and migrants' remittances will flow in opposite directions.

10. *The Terms of Trade.*

If the countries with the least capital available tend to specialise in the labour-intensive industries, it may be argued that at least the terms of trade between these products and others will improve and that this will offset the lack of earning power which would otherwise characterise these countries.

If Europe as a whole were isolated, such a solution could be expected in accordance with pure classical theory.

But Europe as a whole is not isolated. The lightly capitalised industries (agriculture, textiles, etc.) are precisely those that benefit least from the extension of the market. Moreover, they are in competition with a number of foreign producers and this competition places a ceiling on their prices.

The position would of course be aggravated if, instead of providing outlets for the farm products of the non-industrialised countries, the organisation of European markets for farm products as advocated in the report were to favour the maintenance of competing forms of food production in the highly industrialised countries.

11. *Concealed Underemployment.*

Another factor that would aggravate the position of the poor regions—unless action were taken to correct it—results from the lack of precision in the concept of full employment.

The mechanisms of international specialisation envisaged by classical theory—on which the report is based except when dealing with the "exceptional" case of southern Italy—all assume full employment.

The fact that, in a Europe where barriers had been removed, sociological inertia would be such that a high proportion of the population would remain where it was assumes lack of mobility of manpower which is quite compatible with concealed underemployment.

This—as often happens in agriculture and small-scale retailing—would inevitably keep in existence a relatively unproductive labour force in a state of concealed underemployment.

The maintenance of domestic markets can only foster an uneconomic allocation of labour.

IV. *Likelihood and Extent in Western Europe of the Hypothesis of the Perfect Mobility of Capital (Second Hypothesis)*

12. *Effective Mobility of Capital.*

The conclusions I have drawn from a theoretical hypothesis are serious, but is there any real possibility that they will materialise in a united Europe?

The factors that are most favourable to the mobility of capital would appear to be the geographical proximity of industrial centres located in different countries, the extent of financial and personal links between firms and the preponderance of self-finance in industrial investment.

For these reasons a French textile firm might decide to expand its facilities in the Netherlands rather than in France if any benefit was to be derived from doing so and if, moreover, it could move its skilled workers to its new mills.

13. *Extent of the Shifts That Can Be Expected.*

Moderation is required in gauging the foregoing factors (sections 5 to 11), for the following reasons:

(a) It is unlikely that the shift in the movement of capital will have any strong impact on the existing pattern of industry. It is much more likely that it will affect new investment and even then only progressively. Its consequences can therefore be mitigated during the transitional period.

(b) Centres with scope for efficient development can exist and continue to exist in all European countries, each of which possesses some geographical advantage. The great western industrial zone based on the coal-producing area which includes the mines of north-eastern France comprises five countries each of which, as the experience of the Coal and Steel Community has shown, possesses some advantage. Moreover, certain industries, such as textiles, are less prone than others to geographical concentration. Greater specialisation, coupled with production on a larger scale, can between them save existing industries.

(c) Furthermore, all capital is not equally mobile. Private savings and public capital are less mobile internationally than business savings.

(d) The tendency for shifts to take place will largely affect new industries and new savings. It is unlikely that it will lead to a fall in the living standards of the poor regions, but rather to be expected that these standards will not rise to the same extent as in the rich regions.

14. *Practical Consequences to Be Expected in the Absence of an Appropriate Policy.*

The fact remains that, unless appropriate measures are taken, certain countries, on being given an opportunity of joining a European common market, may with reason feel unable to do so because—

(a) their rate of development might not only be slower than that of other countries (which would not in itself be an adequate objection) but might be slower than if they did not join this common market ; and

(b) this initial difference could not fail to be accentuated as time went on, i.e. as the regions with the best supply of capital (and therefore the highest savings) steadily increased their rate of development.

These possibilities should be considered in so far as they affect not only the existing underdeveloped regions of southern Europe but also Europe as a whole.

15. *The Lessons of Experience.*

We have knowledge of very few cases in which countries that were already developed combined together to form an economic

unit while at the same time reducing instead of raising their external customs barriers.

German unity was achieved under a highly protectionist system which succeeded in preserving the marginal industries.

The example of Italian unity quoted in the report is particularly disturbing, for in this case industry in the kingdom of Naples was ruined by competition from the north, where all Italian development was concentrated, resulting in a wide disparity in living standards.

In practice protectionist systems have almost everywhere been instrumental in fostering the growth of national economies, although they have borne heavily both on the countries concerned and on the rest of the world.

I agree with the report's view that it is most desirable that they should be abandoned, particularly in Western Europe.

I would go so far as to consider it very desirable that they should be abandoned unconditionally in order to create genuine European unity.

But in present circumstances when each country will only "join Europe" if it stands to gain thereby, it would be untrue as well as Utopian to argue that these gains can be guaranteed in the absence of any systematic policy.

The purpose of any such policy would be to substitute harmonious development in the general interest of Europe for the protective tariffs erected by each individual State.

V. *Action to Be Taken in Western Europe in the Light of the Foregoing (Second Hypothesis)*

16. *The Transitional Period.*

I agree with the report that the anticipated difficulties will be reduced if an adequate transitional period is allowed. I also agree that it is undesirable to impose any prerequisites on the liberalisation of trade, provided that this liberalisation is achieved subject to certain conditions.

Above all, if the two aims of liberalisation and harmonisation of economic growth in the various nations are to be pursued simultaneously, frequent cases of arbitration will be necessary. For this purpose, international or supra-national bodies with a broad measure of authority and discretion will have to be set up. The transitional period, if it is to be successful, cannot be expected

to consist of an automatic sequence of events; nor should it be allowed to give rise to interminable negotiations between governments.

17. *The Harmonisation of Social Legislation.*

The basic hypothesis of the report is that both persons and capital will be immobile. Subject to the qualifications stated below, this hypothesis may seem to provide grounds for making a sharp distinction between those social measures whose costs fall on the economy as a whole and those whose impact is confined to a particular industry. This does not apply to the alternative hypothesis I have just put forward (see also section 27 below).

If capital is mobile as between one country and another, and if general or limited measures impose on a country's industries, or on only some of them, a very different level of charges from that borne by all industries, or the competing industries in another country, an effort to harmonise these charges cannot be considered to be abnormal.

While the movement of national savings abroad can be held to be rational and economic (from the European standpoint) if it leads to a better economic use of these savings, it is quite the reverse if it is merely brought about by differences in legislation.

The threat of a flight of capital which has already been held over earlier attempts at social progress would nullify the efforts of the trade unions and governments.

Under such circumstances it would be impossible to expect willing support for plans to integrate Europe.

In short, the absence of any harmonisation of social legislation in Europe could only be justified by falling back on the arguments that have invariably been used against all social legislation in every country. In practice, the least ambitious social legislation would tend to be taken as the standard.

18. *Degree of Harmonisation Desirable.*

If, in relation to the hypothesis under consideration, one rejects the fundamental distinction made by the report, does this mean that according to this hypothesis, a European economy could only be created by imposing uniformity on the social legislation of the countries involved? Certainly not.

A different set of measures could produce a similar incidence. Present-day social conditions in the countries of Europe do not differ so very widely. A country with an abundance of capital,

natural advantages, no expenditure on armaments, etc., can give its workers a privileged standard of living without any need on their part to fear competition from similar industries abroad.

But the following should be recommended:

(a) Without any distinction between measures of general and of limited application, every effort should be made to achieve the social aims which are recognised as common to the countries of Europe.

During the transitional period the process of signing and ratifying international labour Conventions within the European regional framework should be continued, although it is impossible to state in advance either the number or the character of the Conventions that it would be desirable to apply.

It must be hoped, for the sake of the success of the policy of liberalisation, that the measures of harmonisation felt to be necessary should not be too many in number and it should be made clear that there is no need for this to be the case. However, it will be for the negotiators of the agreements to define their scope more precisely.

(b) It should be recognised that the principle of harmonisation arises out of the existence of economically unsound disparities imposed on the yield of capital by the legislation of different countries.

These differences can in many cases be corrected by adopting other methods of financing. Such changes could be recommended to governments without any need for expecting them to bring their legislation into line with each other.

(c) The concept of "unfair competition" should be restored, i.e. competition which is greatly facilitated by lower social standards and which can discourage investment in countries with higher standards.

(d) Should such a situation be recognised, certain safeguarding clauses should be applied to the exporting industries or to the industries suffering from competition from imports, rather than that the liberalisation of trade should be held up.

19. *Measures to Restrict International Movements of Capital.*

The report recognises (para. 262) that international movements of capital caused by differences in legislation may be undesirable.

It accordingly recognises that such movements may be restricted,

but only during the transitional period, the final aim being the freeing of all such movements.

While admitting that the harmonisation of legislation may, when the time comes, appear to be justified by such movements, it does not advise such a policy, arguing that there are "other and simpler means" (para. 263).

The most effective of these means would appear to be the levying of a special tax on the income from capital invested abroad whenever any extra income accrues to the capitalist of the country concerned as a result of the difference in legislation.

This method would involve obvious technical difficulties. Moreover it would not touch capital reinvested abroad out of business profits or outside the firm. Lastly, and above all, it would only affect those individuals who remained in their home countries. It could not touch those businessmen who, or those companies which, owing to a shift in their activities, finally established themselves abroad.

It therefore seems to me unlikely that it will be possible to place effective restrictions on movements of capital in an integrated Europe.

20. *Measures Aimed at Directing the Flow of Capital.*

If we now focus attention on the consequences which can result from the concentration of new capital within a small number of European regions and from disparities in economic growth, we find that orientation of capital movements is essential to the international harmonisation of growth.

This can be achieved in a number of ways, most of which are mentioned in the report, though frequently considered to be applicable only to the underdeveloped areas of southern Europe. Such measures include—

(a) the establishment of a fund for the reconversion of industries in existing industrial areas ;

(b) the concomitant establishment of a fund to promote the adaptation of the labour force ;

(c) the establishment of a fund to promote investment in various developing regions by means of guaranteed rates of interest, loans or subsidies ; and

(d) the establishment of a bank which would lay down as an essential condition for the granting of loans that their purpose

would be to provide temporary assistance to undertakings in areas threatened with stagnation.

These funds and the bank should be international or supranational, since the States most seriously threatened with stagnation would be the least capable of withstanding heavy taxation.

This does not mean that most of the resources required should be provided from international public funds. On the contrary, the major part should consist of private capital, combined with national public funds.

Private interests, however, would be called upon to assume the full responsibility only after the indispensable conditions for decentralised development had been created.

The following should also be facilitated :

(a) agreements regarding specialisation ;

(b) temporary measures of protection, as exceptions to the rule of general and simultaneous lowering of tariff barriers ; and

(c) any other appropriate temporary measures of support.

The statutes of the European Coal and Steel Community show that all of the above-mentioned measures have been recognised as useful. If some of them have been applied only to a slight extent, this is due to the generally favourable conditions enjoyed by the coal and steel industries since 1953.

However, in an integrated Europe, national economies would have to undergo changes far more radical than any which might be necessary in the coal and steel industries.

It would therefore be imprudent and perhaps fatal to the very cause of liberalisation not to consider such measures as essential.

VI. *Immobility of Capital and Labour and Partial Specialisation (Third Hypothesis)*

21. *The Likelihood of Partial Specialisation Only Among European Countries.*

Let us now assume the validity of the hypothesis on which the report is generally based, i.e. immobility of capital and labour, although it is in my view an unlikely one.

Can it be expected in such circumstances that each country will become completely specialised in one or a few fields of production? I believe this to be highly improbable for the reasons set out below.

It must be remembered that sources of supply will continue to exist outside Europe, that each nation will continue to produce domestic commodities and, moreover, that differences in skill and living standards are not as great between European countries as they are between such countries and the rest of the world.

The range of profitable specialisation is, therefore, fairly extensive and it is highly probable, even in fields other than the production of domestic commodities, that competition between European countries will subsist in many fields.

Of course, the principle of comparative advantages applies in the case of partial as well as total specialisation, and is counteracted only by the mobility of productive factors. In the case of partial specialisation, however, the principle does not operate in the same manner as in the case of total specialisation. I believe that some assertions made in the report and in the conclusions are incompatible with the hypothesis of partial specialisation.

22. *The Trend Towards Equalisation of European Wages.*

In its first conclusion the report states that, as long as differences in productivity persist, international differences in the general level of wages will remain an essential condition for the sound allocation of productive resources (para. 269(i)).

I fully agree with this, provided that competition is perfect. However, the question arises whether a common European market will allow differences in productivity to subsist.

The report assumes that it will (para. 210) and hence that international differences in wages will continue to exist after the period of transition.

I consider that under the conditions assumed this assertion is unfounded.

If specialisation is only partial, the price ratio between two products both produced in two different countries is the same; the price of the products in each of the two countries is also the same.

To say, for example, that in France one unit of wheat can be exchanged against two units of rye is tantamount to saying that the same combination of labour and capital is required to produce either quantity. Under certain given technical conditions there is only one combination of productive factors which can yield indifferently two specific quantities of goods. If, therefore, the quantities exchanged are the same in Belgium as in France, the marginal combinations of factors must necessarily be the same.

Since the prices of the goods are the same, the marginal productivity of the factors is the same and the wages are also the same.

Even if one does not fully accept this conclusion, it must nevertheless be admitted that in case of partial specialisation there is a very strong trend towards the equalisation of wages even where there is no movement of labour, as shown by Mr. Ohlin himself.

23. *Consequences of This Trend.*

A trend towards equalisation of wages and marginal productivity in the various European industries cannot in itself justify a policy of harmonisation.

It can, nevertheless, remove some of the disadvantages which might otherwise be ascribed to such a policy.

Harmonisation cannot tend unduly to equalise wages which should have remained different. All that it can do is to distribute the remuneration of labour otherwise than would have been the case in its absence.

The only minimum conditions required for satisfactory harmonisation are that due and cautious account be taken of transitional difficulties ; that all factors of cost be considered ; and that harmonisation be the result of free negotiations and have the consent of the parties concerned.

On the other hand, lack of harmonisation would necessarily imply not an inequality between general situations, which would be incompatible with the equalisation of marginal productivity, but inequalities in the particular competitive position of industries.

VII. *Immobility of Capital and Labour and Complete Specialisation (Fourth Hypothesis)*

24. *Significance of the Hypothesis.*

This hypothesis is that most frequently assumed in the report. It is in my view the most unrealistic of all.

If it be accepted, it is difficult to take exception to any of the views expressed in the report (i.e. that each country has more to gain than to lose from specialisation, and that the gain will in fact be greater for the poor countries, that levels of productivity and wages will remain different, that there is a fundamental difference between measures of general incidence and measures of partial incidence, etc.).

Even so, I would venture to make the following objections.

25. *Relative Frequency of Social Measures of General and Partial Incidence.*

Social measures of general incidence are those which, within a given country, do not affect the relative position of one industry as compared with the others.

Such measures might be defined, as a first approximation, as those having a proportionate effect on the costs of production of all goods.

Thus, a charge proportionate to wages would never be a measure of general incidence, since it would favour the less labour-intensive industries.

It is difficult to imagine a measure which would genuinely be one of general incidence. Possibly a social security scheme financed only through direct taxation and ideally assumed to be entirely without effect on prices might constitute such a measure.

Even in this case, the consequences of such a measure could not be disregarded unless the financing and taxation systems were identical in all countries, failing which intervention would be justified.

26. *A Further Argument in Favour of the Prevalence of Social Measures of General Incidence.*

Beyond this "first approximation", however, there is serious evidence which tends to suggest that measures of general incidence are the most frequent, and that they include in particular all measures not directed at a limited number of industries either in law (e.g. legislation governing mines) or in fact (e.g. legislation on female labour).

It is argued that wages are determined by the marginal productivity of labour, so that, while there may be changes in the distribution of wages, no such changes are possible in the over-all level of wages. Thus, while labour legislation can alter the distribution of wage earners' incomes, it cannot change the overall situation of workers who ultimately must pay the price of any advantage granted.

Therefore, from the standpoint of undertakings, there is no modification in labour cost but merely a transfer of income from some workers to others. The over-all impact of the measures taken is general because it is nil and does not call for any harmonisation.

Some support for this argument is afforded by various concrete

examples concerning, in particular, the incidence of social security in France.

27. *Does the Argument also Apply in the Case of Mobility of Capital (Second Hypothesis)?*

It may be asked retrospectively whether this argument would not also apply where capital is mobile—even though we have already in this case rejected the distinction between measures of general and partial incidence. It does not seem that it would, for the reasons stated below.

A measure of social policy can be "neutral" only as a result of a process in which all factors of the general equilibrium react on one another. It is, for example, through such channels as repercussions on foodstuffs of a rise in the price of manufactured goods, and repercussions on these same prices of an increased demand on the part of wage earners, that the burden may ultimately fall on the wage earners themselves.

Such developments cannot fail to influence capital. If capital is mobile, therefore, it yields to this pressure provided that the latter is sufficiently strong and that there are no other influences at work.

Thus, even if the argument is valid, it does not affect the validity of the earlier analysis based on the mobility of capital.

28. *Limitations of the Validity of the Argument.*

Even under the present assumption, i.e. immobility of productive factors, the argument calls for the following observations :

(a) In theory, the determination of marginal labour productivity divorced from all other factors is contested (Austrian theory of imputation).

(b) In practice there is no inconsistency between the propositions that wages correspond to marginal productivity and that increases in wages (or social charges) may take place at the expense of other income. Where conditions of supply and demand permit of the absorption of a wage increase into the price of the product, wages will increase concomitantly with marginal labour productivity assessed in terms of value.

The well-known nineteenth century evolution of the terms of trade between industrial goods affected by trade union pressures and agricultural products not thus affected illustrates this observation.

(c) There appears frequently to be a monopolistic tendency on the part of employers to maintain low wages when labour is unorganised. When the securing of higher bargaining power by workers in one country is threatened by international labour competition unaccompanied by international competition between employers, the mistrust shown by workers is not altogether unfounded.

(d) It is certain, on the other hand, that the economic limit of workers' claims will depend on the extent to which backward economies can be rationalised and on the elasticity of savings. Unless these conditions are fulfilled, higher wages are incompatible with full employment.

Measures to organise markets and to finance industrial modernisation and reconversion will therefore often be more effective than the harmonisation of national laws. Such measures, however, will themselves often depend on international assistance.

(e) International control of cartels may prove indispensable.

(f) Collective agreements between employers and workers of different nations may prove useful.

(g) Finally, even though under the present assumption and subject to the reservations stated above, a general harmonisation may not be possible or even desirable, a certain degree of harmonisation of the provisions applying to groups of wage earners within an integrated economy can only have favourable psychological results.

VIII. *Conclusions*

Since the report has not ignored any of the hypotheses which I have considered—although it has not ascribed to them the same degree of relative importance and probability, nor presented them in the same order as I have done—I am able to accept the letter of its conclusions, subject, however, to certain differences in emphasis.

I am convinced, with the authors of the report, of the advantages of European economic co-operation and of the need for a fairly long period of transition.

I further agree on the necessity of co-ordinating investment in Europe and on the precedence which such measures should take over all others. Referring back to what I have stated in connection with the second hypothesis above, which I regard as the most probable, I believe, perhaps even more firmly than the authors

of the report, that such measures are essential, that they should be generally applied and that they demand international co-operation.

I concur with the report as to the need for developing the regions of southern Europe, although I regard this as only one aspect of more general measures to direct the flow of capital in the manner most likely to promote balanced growth of all European nations.

As regards the harmonisation of national laws, I believe that the distinction between measures of general incidence and measures of partial incidence will not be of practical significance in most cases.

Nevertheless, I do not advocate uniformity. Some differences might be retained indefinitely and others tolerated during the transition period.

However, since European countries have already displayed some measure of agreement by signing certain international labour Conventions, it is to be hoped that such Conventions will be ratified or at least that the reasons why they have not been ratified will be established with a view to making their ratification possible.

As there is probably wider scope for agreement between States which are all located within the European region than between States located on different continents, it would be desirable to promote the signing of new regional conventions under the auspices of the I.L.O.

While it is not possible to define the exact limits of this effort at harmonisation, it should nevertheless be considered as desirable and fully compatible with the aims of liberalisation.

The progress of European organisation should be linked with that of liberalisation. Nevertheless, clauses providing for execution and compensatory measures are to be preferred to the laying down of prerequisites.

In a united Europe standards of living will tend towards equality. In the long run such equalisation is conceivable only at a level higher than the most favourable level prevailing at present, through a general increase in productivity.

The real social objective of the policy defined at Messina should thus be to avoid any retrogression, even purely temporary, in any country. Such a retrogression, which is by no means inconceivable, would be fatal to the union. To deny this possibility out of excessive optimism is to ignore the fears which it raises.

I am far more in disagreement with the general optimism of

the report than with any particular statement made in it. In my view, it reflects too great a faith in automatic processes. No doubt, excessive resort to negotiations, special agreements and other machinery should be avoided; on the other hand, it is normal that new structures should call for some new measures.

The main danger of over-optimism is that it gives nations the illusion that they will both enjoy the advantages of European unification and remain fully free to take independent decisions.

Any such hope would involve a contradiction.

Moreover it could not be shared by all social groups. The more sceptical, weak or fearful elements would weigh any argument based on a long term approach, no matter how perfect and how logical, against immediate threats to their existence.

These psychological and sociological considerations do not appear entirely irrelevant to the question before us.

(Signed) Maurice BYÉ.

Paris, 12 March 1956.

Supplementary Note by the Chairman

1. The preceding note by Professor Byé was submitted after the group's discussions had been completed and consequently could not be considered by the other members of the group at the time when we were preparing our report. The note naturally dwells mainly on points of difference and it may therefore be useful to draw attention to the extent to which it and our report are basically in agreement.

2. In the course of its discussions the group considered very fully a number of questions on which initially there appeared to be substantial differences of views between Mr. Byé and the other members. Thanks to a common desire to achieve the largest possible measure of agreement, it proved possible to present a carefully balanced statement and analysis of the problems discussed and a set of practical conclusions with most of which Mr. Byé associates himself (see the introduction and conclusions of Mr. Byé's note).

3. Both the report and Mr. Byé's note discuss at length the disadvantages which might follow from unregulated capital movements, including the danger of unbalanced economic growth in different countries; these questions are referred to in paragraphs 32,

41, 53, 54, 59 and 60 of the report and are emphasised throughout Mr. Byé's note. There appears, however, to be some difference in emphasis as regards the need for international direction of capital movements and the establishment of new financial institutions for the purpose of promoting what Mr. Byé calls "harmonisation of economic growth" (section 16); Mr. Byé's suggestions on these points (section 20) go somewhat further than those of the report (paras. 64, 65, 264 ff. and 271 (vi)). The reason for this difference seems to be threefold: first, the group, while it recommended further study of certain proposals, did not examine the details of various schemes for international financial arrangements (para. 65); secondly, some of us doubted whether the establishment of new institutions and the introduction of a workable system of international investment plans would be feasible in the foreseeable future (paras. 152 and 265); and, thirdly, we assumed that capital would not be perfectly mobile, partly for the reasons given in section 13 of Mr. Byé's note, but also because free trade would not necessarily be accompanied by the removal of all restrictions on international capital movements.

4. As regards the harmonisation of social conditions and policies (as distinct from the harmonisation of economic growth), it may be noted that, although we were not convinced that any large measure of such harmonisation will be needed for the purpose of establishing freer trade in commodities, we have recognised the possible need for some such harmonisation (paras. 173, 175, 182, 205 and 262). In terms of practical policy there would seem to be little difference between these passages and sections 18 and 23 of Mr. Byé's note.

5. As regards the basic framework of theoretical analysis, Mr. Byé's paper includes an illuminating and precisely defined set of alternative assumptions on the basis of which, in his view, conclusions concerning policy may be drawn which differ at least in order and emphasis. With reference to some of the issues discussed, such as whether international specialisation would be "complete" or not, I am not convinced that there is any real divergency between the two documents (see for example paras. 24 and 129, and section 21 of Mr. Byé's note). As regards the question whether factor prices, such as rates of wages, will tend to become equal in different countries in conditions of freer trade, there is a difference in emphasis between paragraph 210 and section 22 of Mr. Byé's note. The operation of this tendency depends, of course, on a number of rather stringent additional

conditions which are not analysed in either of the two documents. I shall, however, refrain from commenting on this and certain other questions of theoretical analysis, both because the group did not find it necessary to examine them in detail and consequently did not discuss them in its report, and also because, as I have noted above, Professor Byé is in agreement with most of our practical conclusions.

Stockholm, 28 March 1956.

PART III

APPENDICES

APPENDIX I

INTERNATIONAL COMPARISONS OF WAGES AND SOCIAL CHARGES IN EUROPE

(Prepared by the International Labour Office) [1]

1. As stated in the body of this report, the International Labour Office, with the co-operation of a number of European governments, is undertaking an investigation into wages and related elements of labour cost in Europe, along lines agreed upon at the meeting of statistical experts convened by the Governing Body in May 1955. The results of this investigation are not, however, expected to be available until about the end of 1956. In the meantime, the following study, utilising rough materials already at hand, throws light on some aspects of the subject.

Wages

2. The first two columns of table I on page 33 of the report illustrate the substantial differences prevailing in average hourly earnings in manufacturing industry in a number of European countries.

3. Average earnings, however, are a composite of a number of individual elements which are subject to different influences. Overtime premium pay is an important element. The difference between the normal or straight-time work-week and the hours actually worked per week in different countries introduces variation in hourly labour cost owing to the premium rate which commonly represents an addition of 25 or 50 per cent. of the straight-time wage for the hours worked overtime. In a country such as France, where the statutory work-week is 40 hours but many industries commonly work 48 hours, overtime is evidently significant. Overtime hours vary between industries and between establishments in the same industry, apart from showing seasonal movements.

4. Workers paid on a piece basis or under some other type of incentive system customarily receive higher earnings per hour than similar workers paid on a straight hourly basis. Throughout an entire

[1] In tables A, C and D, the figures given in the original mimeographed document submitted to the I.L.O. Governing Body at its 132nd Session have been slightly revised. This in no way affects the argument in the text of the report.

industry the differential may average no more than 5 to 10 per cent., but individual establishments may pay differentials of 20 per cent. or more to incentive workers.

5. Sex and seniority differentials and premiums for work at night, on holidays, etc., show great variation. Some employers pay female workers one-quarter to one-third less than male workers in the same jobs. Differentials for work on late shifts, on holidays and on Sundays commonly attain 20 to 50 per cent. above the basic wage.

6. It is important to note that many of the premiums mentioned above, while tending to increase average earnings, do not necessarily increase costs per unit of output. Thus, overtime work at premium rates may actually reduce unit costs by permitting fuller use of capital equipment and a consequent spreading of overhead. The same is true of work on Sundays and holidays and the operation of extra shifts. The higher wages of incentive workers are normally accompanied by substantially higher output. Differentials paid on the basis of seniority frequently, though not always, give recognition to greater skill and broader experience.

7. Christmas and year-end bonuses, which are common in Europe, do not necessarily affect the intensity of work or the rate of output or make possible offsetting economies. Such bonuses in many establishments have become so well established that they are regarded almost as part of the basic pay. In some cases they are established by law or agreement, while in others they depend on the decision of the individual employer or on the firm's profits. In a study by the European Coal and Steel Community[1], such bonuses in the steel industry in 1952 were shown to amount to 6.1 per cent. of basic average earnings in the Federal Republic of Germany and the Netherlands, 10.2 per cent. in Luxembourg, and 10.8 per cent. in Italy. They were less important in other countries of the Community, ranging down from 4.6 per cent. in the Saar to 2.7 in France and only 1.6 in Belgium. When the bonus is established without direct reference to the firm's earnings or output, the payment has a distinct effect on labour cost per hour and per unit of product.

8. Payments in kind are an element of wage cost which is often excluded in statistics of average earnings. Such payments are limited in importance in European industry as a whole, and are most common in coal mining. The study by the European Coal and Steel Community showed that in the coal mines of the member countries in 1952 payments in kind (principally coal and housing or cash indemnities paid in lieu thereof) amounted to 6.6 per cent. of basic cash earnings in Belgium, 8.0 in the Netherlands, 9.9 in the Saar, 11.4 in Germany (Federal Republic), 11.7 in Italy (Sulcis coalfields) and 18.3 in France.

9. In summary the wage proper, before introduction of social charges, is itself a complex structure which may reflect a number of elements other than the traditional "hourly rate". With the exception of payments in kind and certain non-production bonuses these elements are customarily reflected in the statistics of average hourly earnings published by European countries.

10. Interest attaches not only to international differences in average hourly earnings in manufacturing but also to differences between

[1] Communauté européenne du charbon et de l'acier, Haute Autorité : *Documentation sur les problèmes du travail dans les industries de la Communauté (Emploi et Salaires)* (Luxembourg, May 1954).

countries in the spread of wages in different manufacturing industries above and below the average, and in the relationship between average wages in manufacturing and in other sectors, for example agriculture.

11. Tables A to D below illustrate the existence of rather substantial differences in the inter-industry wage patterns prevailing in a number of European countries, but show that, notwithstanding these differences, there is also a definite general similarity among the various national wage patterns, on which comments are made in the body of this report. Furthermore, in recent years there has been a tendency for wage differentials, both between industries and between male and female workers, to become narrower. One illustration of this tendency, so far as the inter-industry differential is concerned, is contained in table C.

12. Table D illustrates differences between men's and women's wages in certain occupations in some European countries. These are not inter-industry differentials as such. But differences between countries in sex differentials may be an element accounting in part for differences in inter-industry patterns of labour costs, particularly as between industries employing much female labour and others employing little female labour.

TABLE A. INDICES OF AVERAGE HOURLY EARNINGS OF MALE WAGE EARNERS IN SELECTED INDUSTRIES, 1954

(Base: textile industry=100)

Country	Textiles	Food, drink, tobacco	Paper	Chemicals	Metals and engineering	Construction	Mining and quarrying
Belgium [1] . .	100	98	112	122	123	107	140
Denmark [2] . .	100	99	98	96	108	129	—
France [3] . . .	100	103	103	123	119	111	132
Germany (Federal Republic) [4]	100	102	108	122	120	117	124
Ireland [5] . . .	100	111	140	118	123	123	112
Italy [6]	100	97	112	132	136	—	133
Netherlands [7] .	100	91	95	95	100	97	119
Norway [8] . .	100	97	110	112	111	138	118
Sweden [9] . . .	100	105	114	116	123	155	149
Switzerland [10] .	100	109	112	118	112	116	109
United Kingdom [11] .	100	93	117	105	112	100	143

Source: I.L.O.: ***Year Book of Labour Statistics 1955*** (Geneva, 1955).

[1] Earnings per day, June. Mining and quarrying: hard coal mining. [2] Copenhagen, third quarter. Construction: average of bricklayers, navvies and concrete workers. [3] Both sexes combined, September. Mining and quarrying: hard coal and lignite mining, estimated from average earnings per day. Food, drink, tobacco: food only. Metals and engineering: metals only. [4] Food, drink, tobacco: food only. Metals and engineering: engineering only. Mining and quarrying: hard coal mining, estimates from average earnings per shift. [5] October 1953. Paper: including printing. Metals and engineering: metals only. [6] Both sexes combined. Mining and quarrying: mining only. [7] 1953. Metals and engineering: metals only. Mining and quarrying: coal mining, estimated from earnings per shift. [8] Food, drink, tobacco: food only. Mining and quarrying: mining only. [9] Mining and quarrying: iron mines only. [10] Paper: including leather. Construction and mining and quarrying: related to textiles on basis of estimates for the three industries based on industrial accidents declarations. [11] Paper: including printing. Mining and quarrying: mining only. Partly estimated from earnings per shift.

TABLE B. AVERAGE EARNINGS OF MALE AGRICULTURAL LABOURERS EXPRESSED AS PERCENTAGE OF AVERAGE EARNINGS OF MALE WAGE EARNERS IN MANUFACTURING, 1954 [1]

Country	Percentage
Denmark [2]	63
Finland [3]	56
France [4]	64
Ireland [5]	59
Italy [6]	64
Norway	75
Sweden [7]	65
United Kingdom [8]	57

Source: I.L.O.: *Year Book of Labour Statistics 1955*, op. cit., and national statistical bulletins.

[1] Unless otherwise indicated, daily wages of agricultural workers remunerated wholly in cash are divided by eight and compared with hourly average earnings in manufacturing. [2] Manufacturing: general level of hourly earnings, average of first three quarters. [3] Agriculture: average of summer and winter seasons only. [4] Cash remuneration of farm workers who also receive board and lodging inflated to level of workers remunerated wholly in cash on basis of relationship in 1952 sample survey. Data per month converted on basis of 48-hour week. Manufacturing: general level of hourly earnings for workers of both sexes, September. [5] Agriculture and manufacturing: weekly wages of males estimated from 1954 average for both sexes and 1953 sex differential. [6] Agriculture: unweighted arithmetic average of wages in 112 zones, including all fringe benefits except family allowances, September. Manufacturing: including all fringe benefits except family allowances, September. [7] Agriculture: hourly earnings. [8] Agriculture: weekly minimum rates. Manufacturing: weekly average earnings.

TABLE C. AVERAGE HOURLY EARNINGS OF MALE WAGE EARNERS IN THE ENGINEERING INDUSTRY EXPRESSED AS PERCENTAGE OF CORRESPONDING AVERAGE IN THE TEXTILE INDUSTRY, 1938 AND 1954

Country	1938	1954
Belgium	123 [1]	119 [2]
Denmark	122 [3]	108 [3, 4]
Finland	129 [5]	121 [5]
Germany (Federal Republic)	135	120
Ireland	134	123 [6]
Norway	114 [7]	111
Sweden	135	123
Switzerland	126 [8]	112
United Kingdom	131	112

Source: I.L.O.: *Year Book of Labour Statistics 1955*, op. cit., and previous editions.

[1] Third quarter. Estimate by United Nations Economic Commission for Europe. [2] June. Earnings per day. [3] Copenhagen. [4] Third quarter. [5] 1939; textiles: cotton only. [6] October 1953. [7] Estimate by United Nations Economic Commission for Europe. [8] June 1939.

TABLE D. HOURLY WAGE RATES OF WOMEN WORKERS IN SELECTED OCCUPATIONS, OCTOBER 1954, EXPRESSED AS PERCENTAGE OF HOURLY WAGE RATES OF MALE WORKERS IN SAME OCCUPATION

Country	Textile manufacture	Manufacture of men's cotton shirts	Printing and publishing
	Mule spinner	Sewing-machine operative	Bookbinder, machine sewing
Austria (Vienna)	100	—	100
Belgium (Brussels)	68	—	71
Denmark (Copenhagen) [1]	70	—	61
Finland (Helsinki)	79	—	100
Germany (Federal Republic)	90	65	—
Greece	80	88 [2]	—
Ireland (Dublin)	63	65	44
Italy (Milan)	80	79	78
Netherlands	61 [3]	68	—
Saar	100	100	100
Spain	100	—	—
Switzerland (Zürich)	—	67	—
United Kingdom (London)	—	70	58

Source: I.L.O.: *Year Book of Labour Statistics 1955*, op. cit.

[1] Average earnings. [2] October 1953. [3] Tilburg.

Social Charges

13. Any international comparison of labour costs must be based not on wages alone but on wages and social charges taken together.

14. Reliable comparisons of the cost to employers of the social charges imposed or voluntarily incurred in the different countries are extremely difficult to make. There are not even, as yet, uniform and accepted definitions of the different elements which should be included within the term "social charges", and the same terms are often employed with very different meanings.

15. For the purposes of the present study social charges may be grouped under three headings:

(a) social security programmes;

(b) time paid for but not worked; and

(c) other social charges.

Some estimates of the cost of social charges coming under the first two of these headings can be made, but no useful purpose would be served by attempting here to compare the costs in different countries of social charges coming under the third heading.

Social Security Programmes

16. Contributions to the traditional social security programmes of old age and associated benefits, unemployment insurance, sickness insurance, workmen's compensation and family allowances constitute the bulk of employers' social charges. Table E illustrates the rates of contribution to compulsory social security programmes as of 1 January 1956, assembled by the I.L.O. from the relevant national legislation. Although it is not always possible to subdivide social security contributions in columns relating to the various contingencies, since the contingencies are covered by different schemes in different countries and there are some cases of overlapping, it is believed that the subdivisions of table E give a general picture of employers' contributions to the various programmes. In general, the rates are those applicable to industrial wage earners, though in a few cases the figures represent average rates of contribution covering other groups as well.

17. The cases of the lowest totals in table E point up the problem, referred to in the body of the report [1], of comparing countries with different systems of social security financing. Sweden and the United Kingdom, for example, have broad social security programmes but a high proportion of government financing, to which employers, in common with other sections of the community, contribute through general taxation, while in Ireland and Switzerland the low contribution rates reflect a relatively modest scale of benefits provided by compulsory contributory programmes.

18. Legal rates of contribution for compulsory schemes do not, of course, provide the full picture. Benevolent or contractual programmes (which sometimes cover substantial numbers of employed persons) are not covered. On the other hand, the legal rate of contribution is commonly assessed on wages only up to a given "ceiling", and a contribution which bulks high as a percentage of assessable wages may represent a somewhat lower percentage of the worker's actual earnings.[2]

19. More accurate information regarding the relation of social security contributions to actual earnings in the coal and steel industries in certain countries is given in table F, which is based on reports from establishments in the coal and steel industries of the countries which are members of the European Coal and Steel Community. Contributory funds exist in all of the member countries, and the data differ from those in table E (and even from the results of table E adjusted for the existence of contribution ceilings), first, because certain special provisions apply to the coal and steel industries of some countries, as distinct from industry in general, and, secondly, because actual employer contributions—both voluntary and obligatory—are expressed as percentages of actual wages paid rather than of nominal ceilings. It will be noticed that the variation of contribution percentages in table F appears to be substantially less in the coal and steel industries than the variation in nominal rates of contribution in the same countries shown in table E.

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[1] Chapter IV.

[2] This qualification appears to be particularly important in Italy, where the ceiling for assessment of contributions is considerably below actual earnings.

20. Both tables indicate that, in many countries, family allowances represent the greatest single employer social security contribution. Family allowances have increased in importance in Europe in recent years through the creation of new schemes and the expansion of long-established ones. In France, for example, where some employers paid family allowances even during part of the nineteenth century, and employer membership in allowance equalisation funds was made obligatory in some sectors by a law passed in 1932, the programme was completely revised and expanded after the Second World War. In Italy, where allowances were first established in 1934 and the present scheme was set up in principle in 1940, there has been a continuous increase in the benefits paid. In the Federal Republic of Germany, where family allowances had been paid under collective agreements in a few industries, a national law establishing a general system was passed late in 1954.

21. Family allowances are financed by employers or governments, or by both. In a number of countries the allowance is not limited to workers or wage earners, and in some countries it is paid out of general government revenues to all qualifying persons. The wide variation

TABLE E. LEGAL RATES OF EMPLOYER CONTRIBUTIONS TO COMPULSORY SOCIAL SECURITY SCHEMES IN EUROPE AT 1 JANUARY 1956 EXPRESSED AS PERCENTAGES OF ASSESSABLE WAGES

<table>
<tr><th>Country</th><th>Pensions</th><th>Sickness and maternity</th><th>Employment injury</th><th>Unemployment</th><th>Family allowances</th><th>Total [1]</th></tr>
<tr><td>Austria</td><td>6.0</td><td>3.5 [2]</td><td>2.0</td><td>1.5</td><td>6.0</td><td>19.0</td></tr>
<tr><td>Belgium</td><td>4.25</td><td>3.5</td><td>1.4 [3]</td><td>1.0</td><td>7.5</td><td>17.7</td></tr>
<tr><td>Czechoslovakia</td><td>·</td><td>·</td><td>·</td><td>—</td><td>·</td><td>10.0 [4]</td></tr>
<tr><td>Finland</td><td>1.0</td><td>—</td><td>1.0 [5]</td><td>—</td><td>4.0</td><td>6.0</td></tr>
<tr><td>France</td><td colspan="2">10.0</td><td>3.0 [6]</td><td>—</td><td>16.75</td><td>29.8</td></tr>
<tr><td>Germany (Federal Republic)</td><td>5.5</td><td>3.1 [7]</td><td>1.6 [8]</td><td>1.5</td><td>· [9]</td><td>11.7</td></tr>
<tr><td>Ireland</td><td colspan="2">1.7 [10]</td><td>· [11]</td><td>· [12]</td><td>—</td><td>1.7</td></tr>
<tr><td>Italy [13]</td><td>6.2</td><td>9.3</td><td>3.1 [5]</td><td>3.5</td><td>31.4</td><td>53.5</td></tr>
<tr><td>Luxembourg</td><td>5.0</td><td>1.9</td><td>3.3 [14]</td><td>—</td><td>4.5</td><td>14.7</td></tr>
<tr><td>Netherlands</td><td>1.0 [15]</td><td>3.2-6.5 [16]</td><td>1.6 [5]</td><td>1.1-4.4 [16]</td><td>5.5</td><td>19.0 [2]</td></tr>
<tr><td>Norway</td><td>—</td><td>0.9 [6]</td><td>2.3 [17]</td><td>0.5 [6]</td><td>—</td><td>3.7</td></tr>
<tr><td>Poland</td><td>·</td><td>·</td><td>·</td><td>—</td><td>·</td><td>15.5</td></tr>
<tr><td>Saar</td><td>6.5</td><td>5.0</td><td>1.3 [18]</td><td>2.0</td><td>12.0</td><td>26.8</td></tr>
<tr><td>Sweden</td><td>—</td><td>1.1</td><td>1.1 [5]</td><td>—</td><td>—</td><td>2.2</td></tr>
<tr><td>Switzerland</td><td>2.0</td><td>—</td><td>1.9 [19]</td><td>—</td><td>—</td><td>3.9</td></tr>
<tr><td>United Kingdom</td><td colspan="2">2.5 [10]</td><td>0.2 [20]</td><td>— [12]</td><td>—</td><td>2.7</td></tr>
</table>

Symbol · = not available. — = non-existent.

[1] As the ceiling and other contribution provisions may vary from one scheme to another, it is not always strictly correct to add the different percentages. [2] Maximum rate. [3] 1949 rate. Relates to industrial accidents only. [4] 15.0 per cent. for employers in the private sector. [5] 1951 rate. [6] Estimated average. [7] Average rate 1953, for compulsorily insured persons entitled to cash benefits. [8] 1953 rate. [9] The scheme came into force in 1955. Financed by employer contributions the rate of which varies with fund. No statistics available. [10] Estimated from flat rate contributions for adult men; covers also unemployment. [11] Employer's liability. [12] Included under "Pensions". [13] Rates for "Industry". [14] 1953 rate, relates to industry only. [15] Estimated from flat rate contributions. [16] Rates varying with fund. [17] 1950 rate. [18] 1954 rate. Relates to industry excluding mining. [19] 1954 rate. [20] Estimated from flat rate contribution for adult men.

in employer costs for family allowances is associated, however, not only with government participation in financing in some countries but also with different levels of benefit provided by employer-financed schemes. Thus, France and Italy, whose systems were most costly to employers, also paid the highest benefits (approximately 30 per cent. of average earnings for a worker with non-working wife and two qualifying children). Despite the difficulty of comparing countries in which the Government participates in family allowance financing it is evident that in a number of European countries there are significant differences in the cost of employer-financed family allowances.

TABLE F. EMPLOYER SOCIAL SECURITY CONTRIBUTIONS EXPRESSED AS PERCENTAGE OF WAGES IN THE COAL AND STEEL INDUSTRIES, 1952

Country	Family allowances		Other branches of social security	
	Coal [1]	Steel	Coal	Steel
Belgium	6.2	6.4	16.4	8.7
France	18.2	14.9	17.5	13.1
Germany (Federal Republic)	3.2	1.7	32.8	18.1
Italy	12.4	8.6	30.6	17.4
Luxembourg	—	6.0 [1]	—	12.3
Netherlands	8.8	5.8	26.9	16.4
Saar	12.3	10.8	25.4	15.6

Source : *Documentation sur les problèmes du travail dans les industries de la Communauté*, op. cit. The data reproduced cover both voluntary and compulsory schemes.

[1] Includes direct payments to families outside of family allowance schemes.

Time Paid for but Not Worked

22. The paid annual vacation is now commonplace in Europe, though its duration varies. The different countries also provide for varying numbers of paid public or religious holidays and for days off with pay for jury duty, military service, temporary lay-off, etc. Table G illustrates the cost to employers of days off with pay in a number of European countries ; in principle, the cost of short breaks for rest or refreshment within the working day is excluded.

23. Two points of interest may be noted in table G. First is the large number of countries for which data can be given in comparable fashion. The figure for each country represents primarily the cost of wages paid by employers for a given number of days of vacation and other paid leave, though in a few cases the employer contribution also covers a special wage supplement for vacation purposes. The problem of government participation does not enter the picture. Secondly, while variations in the cost to the employer of days off with pay can be noted, they are substantially smaller than the variations in cost to the employer of other major social charges.

TABLE G. COST TO EMPLOYER OF DAYS OFF WITH PAY AS PERCENTAGE OF WAGES

Country	Average for industry in general 1952-53	Coal industry 1952	Steel industry 1952
Austria	10.1	—	—
Belgium	11.6	11.5	11.1
Denmark	6.5	—	—
Finland	4.5	—	—
France	7.2	7.8	6.6
Germany (Federal Republic)	9.8	9.2	9.8
Ireland	4.6	—	—
Italy	14.2	7.9	12.0
Luxembourg	6.3-9.8	—	9.7
Netherlands	7.2	8.4	11.2
Norway	6.0	—	—
Saar	—	9.9	7.6
Sweden	6.0	—	—
Switzerland	6.0	—	—
United Kingdom	6.0	—	—

Sources: For the general average: "Les charges sociales dans les pays de l'O.E.C.E." in *Etudes et Conjoncture* (Paris, Institut National de la Statistique et des Etudes Economiques), Mar. 1954.

For the coal and steel industries: *Documentation sur les problèmes du travail dans les industries de la Communauté*, op. cit. The data for the steel industry have been recomputed on the basis of a definition of wages more consistent with other data presented in this paper. The data for the coal industry did not require adjustment.

24. While the existence of waiting periods before entitlement to annual leave may make actual vacation costs in some cases lower than the levels shown, general holidays with pay have cost implications to employers over and above the costs shown in table G. Plant and equipment are idle during vacation periods, so that overhead costs must be spread over a shorter period of effective operation and a smaller number of units of product.

Other Social Charges

25. While only the principal social charges can at present be measured statistically for a number of different countries, certain indications are available with respect to items which are not included in tables E to G. Some examples are given below.

26. Various subsidies to workers' housing are found in a number of European countries where—because of their indirect nature and the difficulty of associating them with remuneration for work performed—they may properly be classified as social charges. The study of the steel industry in 1952 made by the European Coal and Steel Community showed, for France, that losses incurred in company housing (i.e. the difference between maintenance costs and the rent paid by the workers) plus new housing investment during the year by the same companies and

occasional indemnities paid to workers not living in company houses amounted to 9.4 per cent. of average wages while the difference between maintenance costs and rents paid in the Saar amounted to 5 per cent. of wages. In the Federal Republic of Germany housing subsidies, including the imputed interest on interest-free housing loans, amounted to 5.6 per cent. of wages in the steel industry in 1952. In Belgium the housing subsidy, including amortisation costs and reimbursement to workers of part of their individual loan payments to low-cost housing societies, amounted to 1.42 per cent. of wages. In Luxembourg the housing subsidy, covering maintenance, amortisation, new investment in 1952, costs of preparing land sold to workers, subsidies on building materials, and certain workers' interest payments on housing loans which were paid in fact by employers, amounted to 3.1 per cent. of wages. Even if the investment components of the above figures were deducted, it is evident that the remaining amounts constitute a significant addition to the volume of social charges.

27. Separation pay or terminal leave pay can be important in the structure of employer costs, as in Italy where 6.4 per cent. of wages in the steel industry in 1952 was paid into a reserve fund to meet separation pay claims.

28. The paid rest or refreshment period within the working day is another cost item which varies widely; it is usually based on an agreement or on simple tradition in a given establishment or industry rather than on country-wide legislation. Obviously, 20 to 30 minutes of paid rest periods in the course of an eight-hour day amount to 4 to 6 per cent. of the working time. In a few cases workers also receive pay for short meal periods. It is difficult, of course, to assess the net cost of rest and meal periods to employers, since it is generally agreed that "rest breaks" increase the workers' efficiency during the time actually worked.

Wages plus Social Charges

29. The final column of table I on page 33 of the body of the report has shown the effects of adding to average hourly earnings in manufacturing percentages reflecting the estimates contained in tables E and G above of the cost to employers of obligatory social charges and days off with pay. The extremely rough and tentative nature of the resulting comparison has been emphasised.

APPENDIX II

TAXATION AND FOREIGN TRADE

by

Professor Bertil OHLIN

1. In scientific economic literature much is said about the effects of taxation on production and economic conditions in general in an isolated country. The analysis has demonstrated that it is difficult to make general statements about the shifting and incidence of taxation, except in special cases. This difficulty may be one reason why the influence of the tax policies of different countries on international trade is a very neglected subject. In view of the great attention that has been given to the effects of taxes of a special sort, namely import and export duties, it is nevertheless strange that the effects of other kinds of tax policy on international trade have been almost completely ignored.

2. A convenient starting point for a discussion of the influence of taxes and social policy on international trade is the thesis that—given a certain commercial policy by governments—relative money costs in the different countries govern the exchange of commodities in the long run, even though the existence of monopolies and monopolistic competition causes deviations from the pattern of trade that would otherwise exist. Through the influence of the foreign exchange rates a situation is brought about in which the costs of some goods—expressed, for example, in dollars—are lower and the costs of other goods higher in each country than abroad.

3. In order to simplify a nevertheless complicated problem let us assume that in all countries concerned essential budget deficits and surpluses are avoided, that a high and stable level of employment and general economic balance is maintained and that every country preserves a long-run equilibrium in its balance of payments with other countries. Such complicating factors as business cycles and other forms of financial disturbances, national or international, are thus kept out of account. This seems justified, as the analysis below is chiefly concerned with certain long-run effects.

4. It is impossible to study the influence of taxation on production and international trade without considering how the proceeds of the taxes are spent. Let us assume that taxation is increased in order to finance new social insurance and other kinds of social benefits. These benefits lead to an increase in consumption by the larger share of the amount that is distributed. Should the new taxes have such a form and character that the institutions and persons that pay the new taxes reduce their savings considerably, then the outcome must be a reduction in total savings compared with the situation that would have existed if taxes and social benefits had not been raised. On the other hand, a part of the social benefits may exercise a favourable influence on the

health conditions and working capacity of the people and will therefore in the long run increase productivity. Such negative and positive indirect long-run effects on production are not taken into consideration in the following analysis, except with regard to their influence on the general level of interest.

5. The new taxes and new social expenditure involve a certain change in the direction of demand. Some goods and factors of production will be in greater demand, others will be less demanded. International trade will be affected in a way that depends on the circumstances of each case.

Taxes on Company Profits

6. It goes without saying that different taxes have different effects because they are imposed in a different way and are shifted differently on to other firms and persons than those who pay them originally. Let us study first the case when extra taxes are levied on the profits of corporations in an isolated country.

7. Such taxes are ultimately paid either by capital owners, wage earners or by all people as consumers. The influence on rents is unlikely to be important except in special cases. If the different parts of the capital and labour markets are in effective communication, the whole interest level will tend to be depressed, as a result of reductions in net profits and dividends. The yield of bonds and loans and savings deposits will fall. However, in the long run higher income taxes on corporations may discourage investment and, as stated above, reduce savings. It is, therefore, uncertain whether the interest level will in the long run be lower than it would have been without the new financial and social policy. Thus, it is quite possible that the greater part of the new taxes will be shifted to the wage earners through lower wage rates and to the consumers through higher prices. (Consumers include wage earners and all other groups.)

8. Firms with very high profits will, however, probably carry a part of the burden. For it is unlikely that the process of adaptation will include so much higher prices for their products that net profits are maintained. There may, however, be cases where, before the imposition of the new tax, prices were kept below the maximum profit level, as the reaction of public opinion would otherwise have been unfavourable and might have led to government control measures. In such cases the new taxes may lead to price increases, which make the maintenance of net profits after tax possible.

9. As to the distribution of the burden between wage earners and consumers, the elasticity of the demand for consumers' goods and other circumstances will be relevant. The result may well be similar to that which is brought about by increased indirect taxation. It seems not unlikely that the consumers will carry the greater share of the burden—in an isolated country.

10. In competing countries which have similar taxation systems, tax increases and public spending policies, it is reasonable to assume that the shifting and incidence of the new taxes may be similar and, on the whole, the same as in an isolated country. But it is by no means certain that the effects will be identical. For differences in the structure

of industry, in the level of income and in trade union policy may lead to different indirect effects of the same taxes. In other words, the shifting and incidence may be different. Furthermore, international trade may be affected also because of the fact that the profits and the tax proceeds may be a greater proportion of the total value of output in one country than in another. It is, however, reasonable to assume that the influence on international trade will be much smaller than when the tax systems and tax increases are widely different.

11. Before proceeding to a discussion of this latter problem, we would draw attention to the case when communications between different parts of the labour market are incomplete and less efficient in one country than in another. This is the case of non-competing labour groups. Let us consider the case when real wages in one country —but not in the others—are much higher in manufacturing industries than in agriculture. As company taxes are chiefly paid by manufacturing industries the outcome may be a reduction of the wage differential in such industries compared with wages in agriculture in that country. No such change in relative wages will take place in the other countries. Hence, international trade will be affected.

12. Let us consider also the case where the structure of relative wages is similar in all countries and where, consequently, a tendency to the same change in relative wages will appear in all countries concerned as a result of the new tax. If this tendency should be of the same strength everywhere, international trade will not be much affected. But if the structure of industry and the strength of the trade unions and employers' associations are different, then relative wage levels may be affected differently in these countries. If so the development of manufacturing industries may be hampered in countries where the relative wages of wage earners in such industries are least reduced or not reduced at all (compared with what they would otherwise have been).

13. In the case of non-competing sectors of the capital market, a reduction of net dividends in industrial companies may have little or no depressing influence on the general interest level. Should the long-run effect be an unchanged interest level on the loan market, however, it seems unlikely that a considerably reduced level of net dividends from industrial companies can be maintained in the long run. A reduction of profits in companies where they would otherwise have been very high is another matter.

14. Probably the most important problem concerns the effects of different tax policies. Let us assume that two countries A and B have until now taxed company profits to the extent of 30 per cent. Dividends are taxed in the same way as other personal incomes. What will happen if country A increases its tax on company profits from 30 to 60 per cent., while it is kept unchanged in country B? If B represents the rest of the world and is, therefore, much larger than A, it will be difficult for A to raise the average prices of its export goods considerably. Consequently, the tax burden cannot to such an extent as in earlier cases be shifted to the buyers of the products through higher prices. On the whole, country A will not be able to maintain a higher average price level than before the tax increase—at least, not higher average prices for internationally traded goods. Hence, the burden of the new taxes in country A will to a greater extent be carried by the wage earners. In other words, the trade unions will not be able to lift wages as fast as

would otherwise have been possible in a progressive society. It is not probable that the interest level will be much reduced in the long run, but the companies with very large profits will carry a part of the burden just as in other cases. As wages will not be reduced by the whole amount of the tax the industrial firms in A will, however, tend to raise their prices somewhat in an effort to maintain net profits after taxes. Thus the development of manufacturing industries in country A will be hampered by a reduction of its competitive capacity. On the other hand, the negative effect on real wages in manufacturing industries in country A will depress wages in other industries also—of course, only in the sense that they will be lower than the real wage level that would otherwise have existed. Hence agriculture will be stimulated in this country. Average prices for farm products may be a little lower and average prices of manufactured goods a little higher than they would have been if the new tax had not been imposed. In the rest of the world there will be a tendency in the other direction.

15. However, to the extent that non-competing labour groups exist, the outcome may be a very considerable fall in the real wages in manufacturing industries in A. Costs in the narrow sense excluding taxes will then be lower than before. Firms with low profits will be lifted above the margin in the sense that their net profits are increased. But other firms earning larger profits will be hampered.

16. Different rules for depreciation and valuation for tax purposes may affect the burden of taxes on corporations. If such rules and stipulations are made more liberal in one country than in the rest of the world, then part of the profits in such a country will not be taxed at all. This advantage will be more considerable for industries that require large amounts of fixed capital, machinery and commodity stocks per unit of labour. Hence the development of such industries will be stimulated. It is possible that not only the cost effect of such a tax policy but its stimulating effect on company savings and the willingness to invest in new and efficient machinery may be very considerable.

17. The influence of company taxes on international capital movements is obvious but difficult to appraise. High company taxes tend to discourage foreign investment in the countries concerned. It is possible that in this way the immigration of technical knowledge and skilled labour may also be hampered.

18. So far the analysis has been concerned with certain long-run effects. As to the more immediate influence of increased company taxes, it seems obvious that the burden will in the beginning to a large extent fall on profits. The strength of trade unions and employers' organisations will determine how fast a part of this burden can be shifted on to the wage earners. It is possible that the shifting of part of the burden to the buyers of the products will also be a relatively slow process requiring several years. Consequently, profits and company savings may be much affected in the first few years. Such short-run effects will in their turn have indirect effects in the long run.

Taxes Proportional to Wages

19. We believe that taxes and social security payments that are roughly proportional to wages and salaries will not in the long run

increase labour costs, except in the case of undertakings earning abnormally large profits. In general and in the long run it seems likely that the total amount of labour costs which business enterprises are able to sustain will not be much affected by such taxes. If trade unions are powerful enough to force upon industry wage rates and labour costs which are above the "equilibrium" level they will be able to do this irrespective of whether or not there are taxes proportional to wages. It is hardly probable that their ability and determination to keep net profits at a low level through such wage policies will—in the long run—be affected by the imposition of certain taxes five or ten years earlier. If, on the other hand, some kind of market mechanism does, on the whole, determine the "equilibrium" position of labour costs, then it will not matter whether these costs consist of wage payments alone or are composed of a sum of wages and taxes. Consequently, such taxes will in the long run be shifted to the wage earners. Relative costs of production will therefore not be affected. International trade will go on as it would have done without such taxes except for the possible indirect effects mentioned earlier.

20. Obviously the short-run effects, which may be very important in practice, will depend on the general economic situation when the taxes are imposed. In the case of overfull employment the tax may be added to the wage bill and may, hence, lead to increases in total labour costs. It will therefore lift the cost level in terms of money and bring about disturbances in international trade.

Taxes on Personal Income

21. Personal income taxes are probably much less shifted to other people through price or wage changes than most other taxes. However, if high income taxes reduce the willingness to work and therefore limit the supply of labour of certain types, e.g. of doctors, their scarcity and payment may be increased. In some cases a general reluctance of industrial workers to work overtime can in the long run increase hourly wages at the expense of the income of capital owners. (It goes without saying that increased income taxes may lead trade unions to increase wage demands and that, in the short run, wages may therefore be increased.)

22. On the other hand, highly progressive income taxes may reduce the propensity to save and the supply of capital. It is not certain that interest levels will be raised thereby, for the incentive to invest may be weakened by heavy taxes on large incomes. However, if a policy of full employment is pursued, it seems probable that in the long run a reduced willingness to save will tend to increase the level of interest rates. Special taxes on income from capital are almost certain to have this effect.

23. A taxation policy of this kind naturally tends to discourage immigration and to stimulate emigration of engineers and technically skilled persons in general as well as of capital.

Consumption Taxes

24. Taxes on consumers' goods that increase retail prices but not wholesale prices, and are used to finance social expenditure in a certain country, need not affect savings or production. However, they mean a lower real income for people who do not benefit from social expenditure, and these people will therefore probably reduce their savings. Thus, total savings will decline unless the payment of social benefits brings about increased savings from the beneficiaries and from the parents and children of the people who now obtain better pensions, etc. Except for indirect effects on international trade from a possibly reduced supply of capital the main effect on trade will come from the change in the general direction of demand.

Indirect Taxes on Production and Trade

25. Let us assume that indirect taxes are levied in the sphere of production in such a way that wholesale prices, including export prices, are increased. Costs of production will rise more for some goods than for others, e.g. in the case of a turnover tax. If no such taxes are imposed abroad, the average price level cannot remain on a higher level than before—not, at least, as far as internationally traded goods are concerned. Hence, nominal wages and salaries will be lower than they would otherwise have been. Wage earners will carry a considerable part of the burden. However, some industries pay a greater share of the tax than others. Their development will be kept back. In practice taxes of this kind usually weigh most heavily on manufacturing industries, and will therefore tend to discourage the development of such industries. Furthermore, export industries cannot raise prices as much as home-market industries and will, therefore, be hampered.

26. If the taxes should be levied in such a way that export commodities are unaffected or if the taxes on export commodities—and on raw materials and semi-manufactured goods used in export industries—are repaid or compensated for by subsidies, the effect of the taxes will probably be to increase prices and reduce nominal and real wages in home market industries. Any tendency for nominal wages to be lower than they otherwise would have been will tend to stimulate export industries.

General Observations

27. It is a fact that productivity normally rises by a certain percentage each year and that nominal and real wages therefore have a rising tendency that explains how some taxes can be shifted to the wage earners even in countries where trade unions are strong. For a shifting of new taxes in this way does not prevent a certain increase both in nominal and real wages—although a slower one than would otherwise have occurred.

28. The very sketchy analysis above seems to corroborate the opinion that several types of taxes are ultimately—at least to a large extent—paid by other individuals than those who are responsible for

the actual payment to the State. A second conclusion is that a higher level of taxation in one country than in others need not mean a permanent reduction of the competitive power of industry in that country. Taxes will, however, change the pattern of international trade when they are imposed in such a way that they fall much more heavily on certain kinds of activity than on others—and differently in different countries. Our general impression is that when the tax systems are widely different in different countries the influence on international trade will be considerable in the long run. Considerable differences exist, for example, between some countries in southern Europe on the one hand and some in northern Europe on the other.

29. Besides, the short-run effects of changes in taxation (like the effects of all disturbances, e.g. much higher wage increases in one country than in other countries) may of course be highly important and unfavourable. This fact speaks in favour of a certain caution in tax policy and a general economic policy which tends to bring about a smooth adaptation to changing circumstances, thus in large measure avoiding unfavourable effects.

30. Long-run effects of taxes on international trade may also be important, when tax policy considerably affects willingness to work and to save and thereby affects production. Differences in taxes, e.g. in depreciation rules and in the double taxation of company profits—and in taxation on income and wealth—may also affect the international movement of capital and certain types of labour, thereby affecting also production and trade.

APPENDIX III

TWO NOTES ON TARIFF REDUCTIONS

by

Professor P. J. Verdoorn

1. The first part of this appendix presents a qualitative analysis of the social and economic implications of two main forms of systematic tariff reductions. In the second part some quantitative estimates are given of the impact of tariff reductions on the pattern of trade.

A. Social and Economic Implications of Two Main Forms of Tariff Reductions

2. If a certain period of transition has been agreed upon in which tariffs are to be completely abolished, the relative size of the successive reductions within this period still remains to be decided.

3. In the event that a uniform system is contemplated, under which the reductions to be made by each of the participating countries for all commodities or for groups of commodities would be prescribed, the following two main possibilities may be considered :

(a) equal reductions per unit of time by fixed percentages of the tariffs existing at the beginning of the period of transition ; and

(b) gradually decreasing reductions, the most straightforward possibility being reductions by a fixed percentage of the residual tariff prevailing at the beginning of each current year.

The first method may be described as the linear method, the second as the geometric method.

4. From the social and economic point of view the impact of these two methods will not be the same. Preference should generally be given to the system that reduces to a minimum the wastage from unemployment of labour and capital caused by tariff reductions. In order to arrive at a minimum of wastage, each subsequent reduction of the tariff must have the same impact on the pattern of production. This does not mean, however, that equal reductions per unit of time will be equal in their impact and that equal reductions will therefore guarantee a minimum unemployment of labour and capital. As a matter of fact, there are strong reasons to expect that a series of gradually decreasing reductions, as in the case of the geometric method, will lead to a more equally distributed impact. This will be true both as regards any single country over a period of time as well as between countries for the period of transition as a whole. [1]

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[1] For a more complete discussion of the problems involved in liberalisation in steps, see P. J. Verdoorn: "A Customs Union for Western Europe", in *World Politics* (Princeton University, Center of International Studies), Vol. VI, No. 4, July 1954, pp. 482-500.

Advantages for the Individual Countries

5. As regards advantages to individual countries, the following considerations apply:

(a) Many tariffs are higher than would be necessary merely for protectionist reasons. A relatively large reduction of tariffs in the initial period will therefore be possible without any decline in production.

(b) To the extent that protection is effective, a greater number of firms may enjoy relatively large profits than would be the case under free trade. The first cut or cuts in duties may therefore have no effects on output.

(c) Even when prices fall below costs of production as a consequence of increased imports, price saving measures can still be taken and efficiency may be increased. But the possibilities of so reducing unit costs will necessarily diminish in the course of time. Eventually, additional investments for modernisation and, finally, complete reorganisation will be necessary if the industry is to survive. That is to say if successive equal reductions are to be effected in unit cost, a larger period will be required on each occasion. Conversely, if it is desired to produce an equal impact per unit of time, the annual decrease in prices and hence the annual tariff reduction will need to be progressively smaller.

(d) A less self-evident but not less important point is the following. The supply curve of home production and imports can usually be assumed to be S-shaped, since the distribution of firms by unit costs will tend to be normal or logarithmically normal. If the tariff has hitherto permitted only negligible imports, it follows that with a first reduction only a very small number of the lowest-cost foreign suppliers will be able to compete on the home market of the importing country. In the same way the number of high-cost producers of the importing country that will have to withdraw from the market will still be very small. But with each subsequent tariff cut by an equal amount the volume of new potential imports will increase rapidly until the steepest portion of the supply curves has been reached. The diagram on p. 163 shows more clearly than any argument the necessity of making each following reduction smaller than the preceding one if equal impact per unit of time is to be achieved. [1]

[1] The diagram assumes prices on the home market to be as high as 120 before tariff reductions are introduced. The original tariff being as high as 40, only importers with costs of 80 or less are able to engage in price competition with home producers. If after a number of reductions the tariff has been reduced to 20, importers with costs higher than 80 are in a position to compete successfully.

It is important to note that prices on the home market of the importing country will not be reduced by the same amount as the tariff. As a matter of fact, apart from the price elasticity of consumers' demand, the new level of prices is determined by the marginal supply of imports and home production at a given increase or decrease of prices.

This rate of marginal supply is represented for both cases by the shaded columns in the graphs. The diagram clearly shows that, if tariffs have been perfectly effective so as to include all foreign competition, marginal supply

Advantages from the International Point of View

6. Since the general level of tariffs differs markedly from country to country, a uniform period in which reductions were to be completed would affect labour as well as capital equipment rather unevenly in the different countries.

7. Only in the case where the period of transition coincides with the average life span of labour and capital will this objection against a uniform period be invalid. In this case the adaptation to the new pattern of production as required by the creation of a common market can be effected simply by not replacing labour that has retired and capital that has been scrapped. If in addition the method of reducing the tariff has been chosen in such a way as to ensure equal impact over the period as a whole it will theoretically be possible to avoid any transitional unemployment.

8. The average life span of invested capital is about 25 years. The average time during which a person is employed in a particular industry is also about 25 years, allowing for normal changes in occupation. Choosing the geometric method of tariff reduction in order to ensure more equal impact over a period of time, and applying this method by way of comparison to both a "protectionist" tariff and a "liberal" tariff, the resulting schedules for complete reduction within a 25-year period are as shown in table 1.

9. This combination of the 25-year period as average life span of labour and capital with the geometric method of reduction leads to the following results :

(a) Although the method of reduction applied to both tariffs is identical, it automatically provides a much longer period of relative shelter for the industries accustomed to the protectionist tariff (50 per cent.). This will undoubtedly facilitate their adjustment to more effective methods of production or their conversion to more promising products.

(b) In practice it turns out that fairly "liberal" tariffs—of say 10 per cent. or less—will be reduced to 2 per cent. or less within ten years. On the other hand, decidedly protectionist tariffs will become fairly liberal within ten years and will be reduced to 3 per cent. after 15 years.

(c) A period of 15 years appears therefore to be sufficient to bring about for all participating countries an almost complete reduction to the insignificant level of 3 per cent. or less.

(d) Clearly, the application of a simple and uniform percentage reduction of residual tariffs can largely replace the use of escape clauses and exceptional remedies, since the period of adaptation granted in the protectionist case (that of a 50 per cent. tariff) is automatically twice as long as in the liberal case (that of a 10 per cent. tariff).

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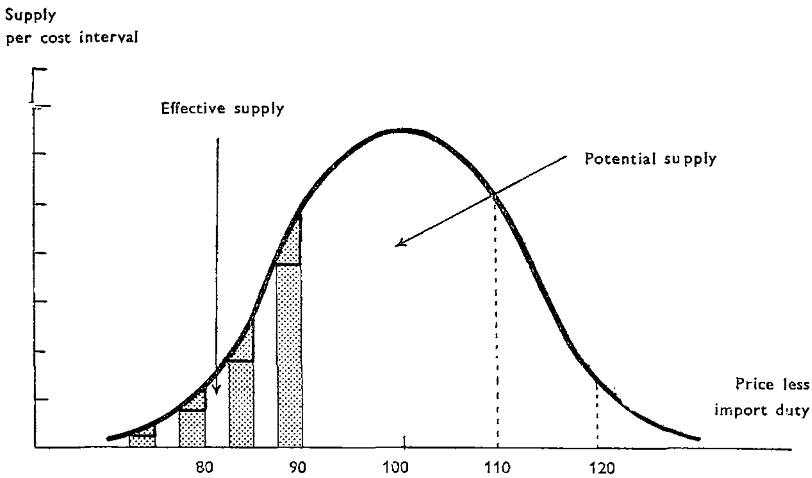
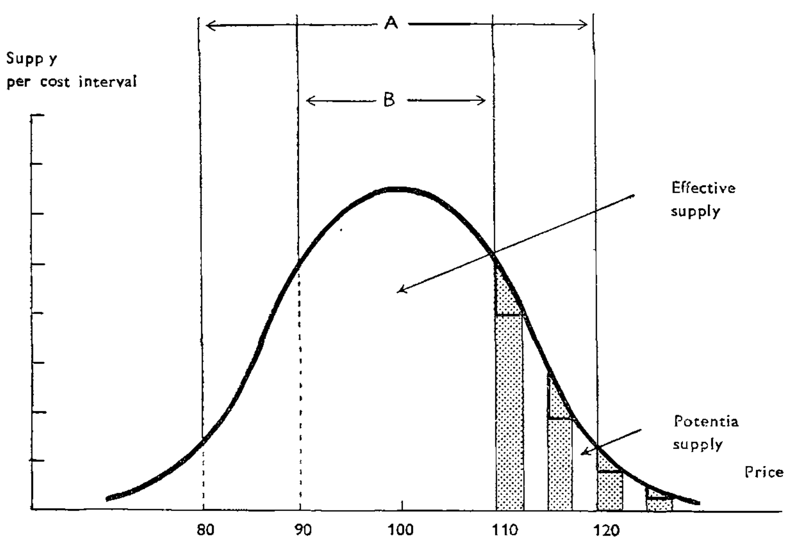
of imports and hence substitution of home production by imports will increase rapidly until on one of the two curves concerned the point of the maximum rate of supply has been reached.

THE IMPACT OF SUCCESSIVE TARIFF REDUCTIONS ON IMPORTS AND DOMESTIC PRODUCTION

I. Imports



II. Domestic Production



A = Original tariff.
B = The same after a reduction of one-half.

TABLE 1. GRADUAL REDUCTION OF A TARIFF BY A FIXED ANNUAL PERCENTAGE OF ITS RESIDUAL LEVEL

Year	Residual tariff	Original level: 50 per cent. (computed on ad valorem basis)		Original level: 10 per cent. (computed on ad valorem basis)	
	(as a percentage of its original level)	Remaining tariff	Annual decrease in import price plus duty (percentage)	Remaining tariff	Annual decrease in import price plus duty (percentage)
0	100.0	50.0	—	10.0	—
1	83.0	41.5	5.7	8.3	1.5
2	69.0	34.5	4.9	6.9	1.3
3	57.0	28.5	4.5	5.7	1.2
4	48.0	24.0	3.5	4.8	0.9
5	40.0	20.0	3.3	4.0	0.8
6	33.0	16.5	2.9	3.3	0.7
7	28.0	14.0	2.2	2.8	0.5
8	23.0	11.5	2.2	2.3	0.5
9	19.0	9.5	1.8	1.9	0.4
10	16.0	8.0	1.4	1.6	0.3
15	6.0	3.0	0.5	0.6	0.1
20	2.5	1.5	0.5	0.25	—
25	1.0	0.5	0.2	0.1	—

B. The Influence of Tariff Reductions on the Pattern of Trade

10. A qualitative analysis of the various effects of a customs union on trade has already been presented in Chapters II and IV of the report. Of course, no exact forecast of all these effects of a customs union can be made. In principle there are two methods of evaluating the consequences to be expected. In the first place one can have recourse to the experience of a customs union that has already been established. The only example available is Benelux, for which some figures will be presented at the end of this appendix. In the second place, since the existing pattern of trade is fairly well known from statistics of international trade, it is possible to attempt some *a priori* estimates of the extent to which the demand for imports would be affected if tariffs between participating countries were abolished and a uniform tariff against outside countries were established. [1]

11. The demand for imports from a particular country is governed by the ratio of the export price concerned to the average price of all competing exports of the same class of product. Moreover, it is governed

[1] The mathematical model underlying the computations of this part has been published in a paper on the bases and prospects of European economic integration, prepared for the Dutch Economic Society (P. J. Verdoorn: *Welke zijn de Achtergronden van de Economische Integratie in Europa?*, The Hague, Martinus Nijhoff, 1952).

by the ratio of average import prices and prices of home production in the importing countries. The corresponding elasticities, i.e. the elasticity of substitution and the price elasticity of import demand have been the object of a number of statistical investigations by several authors.

12. As far as this empirical evidence goes, it suggests that—in the case of final and semi-finished products—the values for the elasticity of substitution tend to cluster around —2.0, while in the case of the elasticity of import demand a much lower figure of about —0.5 strongly suggests itself for most European countries.

13. It therefore seems worth while to apply—by way of experiment —these elasticities to the present pattern of trade in Europe and to compute the consequences of an abolition of import duties, taking into account the consequences of the maintenance of a common tariff against non-participating countries.

14. The results of this experiment as presented below deal with a customs union among the O.E.E.C. countries. In order to keep the computations within the limits of feasibility, the participating countries are restricted to : (i) the United Kingdom ; (ii) the three Scandinavian countries, considered as a single participating area ; and (iii) the member countries of the European Coal and Steel Community (E.C.S.C.), each of them considered as a separate unit.

15. The pattern of trade used as a starting point for the computations is that of 1952 ; raw materials as well as products dealt with by the E.C.S.C. are excluded. The tariff applied to non-participating countries is—for each of the nine commodity groups that are distinguished—the weighted average tariff prevailing in 1952.

16. Finally, it should be emphasised that the numerical results presented are to be considered as minimum estimates of the effects of a customs union. There are three reasons for this :

(a) Quota regulations and other quantitative restrictions as still prevailing are not taken into account. Thus the effect of abolishing quotas, etc., should be added to that of the abolition of tariffs.

(b) The computations take into account only the immediate effect of changes in relative prices as a consequence of tariff reductions. Secondary effects, such as the influence of increased productivity and of intensified promotional effort by the exporting countries, are left out of consideration.

(c) Due to the techniques of computation adopted, the figures presented may tend to underestimate the shifts of trade in the case of tariffs which afford complete protection.

17. Although the figures presented may for these reasons underestimate the total effect on the volume of trade, there is on the other hand no reason to expect that their general indication as to the direction of the shifts in trade will be markedly biased.

18. Taking into account these limitations, the results of our experiment are as follows :

(a) The most important result of the abolition of tariff walls between participating countries will be an increase in intra-bloc trade by about

20 per cent., or 1,000 million dollars, in terms of 1952 conditions (see table 2).

(b) It is important to note that for each of the participating countries the absolute increase in total exports exceeds that in imports. As a matter of fact, in some cases, imports from within the bloc increase by a greater amount than the corresponding exports. But these differences are more than offset by a decrease in imports from non-partner countries. Actually 60 per cent. of the total increase in intra-bloc trade comes about because trade is diverted from the outside world.

(c) For this reason the over-all position of the balance of payments of each participating country will benefit from the customs union. A yardstick for this change in over-all position may be found by assuming that each country will revise its rate of exchange so as to maintain its initial surplus or deficit on current account. The change in exchange rate thus required will indicate the degree to which the monetary situation of a country will be affected by the union. As might be expected from the foregoing, table 3 shows that no country should have to contemplate devaluation as an immediate effect of the tariff cuts. But the degree in which an appreciation is possible varies inversely with the average level of the former duties. This apparently means that high tariffs are equivalent to overvaluing the currency of the country under consideration.

(d) The fact that devaluation can be avoided even when fairly high tariffs are removed points to the vital importance of the uniform tariff against non-participating countries. Table 4 shows for different levels of the uniform tariff the corresponding corrections of the rates of exchange that would be required if participating countries were to maintain the initial surplus or deficit on current account.

(e) The detailed results for the four most important commodity groups show that in intra-bloc trade exports will increase as well as imports. Besides, the percentage changes in imports and exports tend to be in most cases of about the same order of magnitude. This seems to point to the conclusion that the formation of a customs union will, in its initial effects at least, foster the exchange of commodities within each industry group through an extended division of labour, rather than convert particular countries from importers into exporters of the product groups concerned or vice versa.

19. It is interesting to compare the *a priori* estimate of a 20 per cent. increase in intra-bloc trade with the actual results obtained in the case of Benelux. As the Benelux union was established in 1948, the best years for comparison are perhaps 1938 and 1954, so as to eliminate the particular influences of the period of reconstruction. If, then, one compares the share of exports of industrial products to partner countries with total industrial exports, one obtains the results shown in table 6.

20. The increase appears to be quite considerable and about three to four times as great as the estimated increase for the O.E.E.C. countries. It should be remembered, however, that the results of Benelux, as presented here, refer to the entire effect of establishing a customs union and not only to the initial effects of abolishing the tariff walls. Moreover, there are reasons to assume that the smaller the area covered by the union the greater will be the increase in intra-bloc trade, for the influence of price differences tends to be dampened as the geographical distance involved is increased.

TABLE 2. EXPECTED CHANGES IN TOTAL INTRA-BLOC TRADE
(In millions of U.S. dollars, 1952 prices)

Countries	Exports	Imports
Denmark, Norway and Sweden . . .	233	118
Belgium and Luxembourg	85	72
Netherlands	141	47
United Kingdom	147	310
France	120	139
Italy	103	88
Germany (Federal Republic)	164	219
Total . . .	993	993

TABLE 3. AVERAGE TARIFFS PRIOR TO LIBERALISATION AND POSSIBLE APPRECIATION IN RATES OF EXCHANGE

Countries	Possible appreciation in exchange rates (percentage)	Weighted average of tariffs prior to liberalisation (percentage)
Germany (Federal Republic)	1.9	33.5
Italy	3.8	24.9
France	2.3	21.9
United Kingdom	3.4	12.4
Netherlands	9.7	11.0
Belgium and Luxembourg	5.7	10.2
Denmark, Norway, Sweden	10.0	9.7

TABLE 4. "REQUIRED" CORRECTIONS IN THE RATE OF EXCHANGE CORRESPONDING TO DIFFERENT LEVELS OF THE UNIFORM TARIFF AGAINST NON-PARTICIPATING COUNTRIES
(Percentages)

Countries	No tariff against non-participating countries	Uniform tariff equal to		
		50 per cent. of average tariff prior to union	Average level of tariff prior to union	125 per cent. of average tariff prior to union
Denmark, Norway and Sweden . . .	—2.1	+4.0	+10.0	+13.0
Belgium and Luxembourg . . .	—5.0	+0.4	+5.7	+8.4
Netherlands	—4.7	+2.5	+9.7	+13.3
United Kingdom . .	—7.2	—1.9	+3.4	+6.1
France	—10.2	—3.9	+2.3	+5.4
Italy	—8.7	—2.5	+3.8	+6.9
Germany (Fed. Rep.)	—10.3	—4.2	+1.9	+5.0

TABLE 5. EXPECTED INCREASES IN INTRA-BLOC TRADE

Countries	Food and agriculture		Machinery and transport equipment		Textiles, yarns and fabrics		Chemicals	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
(a) *Value Changes in Millions of U.S. Dollars, 1952 Prices*								
Denmark, Norway, Sweden	181	28	17	43	1	21	4	9
Netherlands	97	10	9	20	6	4	7	4
Belgium and Luxembourg	19	12	5	27	14	5	9	6
United Kingdom	30	179	60	38	19	26	10	19
France	46	42	20	40	13	9	11	11
Italy	63	26	13	31	16	4	3	8
Western Germany	14	154	88	13	16	16	21	8
Total . . .	450	450	212	212	85	85	65	65
(b) *Percentages*								
Denmark, Norway, Sweden	33	29	18	9	18	9	19	9
Netherlands	20	27	10	8	8	4	12	6
Belgium and Luxembourg.	30	7	5	11	9	8	12	9
United Kingdom	36	28	13	22	14	23	13	19
France	33	37	15	19	17	20	14	18
Italy	35	38	17	24	19	21	14	21
Western Germany	32	37	14	17	16	19	14	18
Total . . .	29	29	13	13	13	13	14	14

TABLE 6. BENELUX : EXPORTS TO PARTNER COUNTRIES AS PERCENTAGE OF TOTAL EXPORTS

Countries	Years		Increase (percentage)
	1938	1954	
Netherlands	10.2	16.5	65
Belgium and Luxembourg	12.2	21.6	77

21. The most important thing to note, however, is that the results of Benelux corroborate the findings of the *a priori* estimates in so far as the increase in exports from the Netherlands to Belgium and Luxembourg appears to be of the same order of magnitude as the increase in the opposite direction, although wage costs in the Netherlands are much lower than in Belgium (see table I on page 33, which shows a figure of 62 for the Netherlands against 88 for Belgium). This tends to confirm the view that a customs union will not necessarily dislocate the balance-of-payments position of the countries concerned, even if differences in costs of production are considerable.

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(Unaccompanied numbers refer to paragraphs in Part I; those preceded by the letter B refer to Professor Byé's note in Part II; those preceded by the letter C refer to the Chairman's supplementary note in Part II; and those preceded by Roman numerals refer to the corresponding appendices in Part III.)

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